Appendix 1

MEDWAY COUNCIL

AUDIT COMPLETION REPORT

Audit for the year ended 31 March 2017

13 September 2017

BDO

CONTENTS

CONTENTS ... 1
SUMMARY ... 2
INTRODUCTION ... 4
OUTSTANDING MATTERS ... 5
KEY AUDIT AND ACCOUNTING MATTERS ... 6
OTHER REPORTING MATTERS ... 22
CONTROL ENVIRONMENT ... 23
WHOLE OF GOVERNMENT ACCOUNTS ... 24
USE OF RESOURCES ... 25
APPENDIX I: AUDIT DIFFERENCES ... 29
APPENDIX II: RECOMMENDATIONS AND ACTION PLAN ... 32
APPENDIX III: MATERIALITY ... 35
APPENDIX IV: INDEPENDENCE ... 36
APPENDIX V: FEES SCHEDULE ... 37
APPENDIX VI: DRAFT REPRESENTATION LETTER ... 38

SUMMARY

AUDIT SCOPE AND OBJECTIVES	
Audit status	We have substantially completed our audit procedures in accordance with the planned scope and our objectives have been achieved, subject to resolution of matters set out in the outstanding matters section below.
Audit risks	Subsequent to our Audit Plan to you dated 9 March 2017, we have elevated the risk level of two of our financial statements audit risks from 'normal' to 'significant'. These are as follows: • Valuation of property, plant and equipment (PPE) - due to the level of inherent uncertainty and judgement involves in the valuation of PPE. • Completeness, accuracy and valuation of NDR appeals provision - due to the variance identified from our preliminary analytical review of the financial statements exceeded our expectations. The above significant audit risks were communicated to you in our Risk Update Letter dated 11 July 2017. No other significant audit risks were identified during the course of our audit procedures.
Materiality	Our final materiality is £11.6 million. This has been updated from our Audit Plan to reflect final amounts in the financial statements.
Changes to audit approach	There were no significant changes to our planned audit approach nor were any restrictions placed on our audit.

KEY AUDIT AND ACCOUNTING MATTERS	
Material misstatements	A prior period adjustment has been made to derecognise two properties which had been capitalised within property, plant and equipment with a value of £50.94 million at 31 March 2017. These properties had been built for two Academies which should have been accounted for as Revenue Expenditure Funded from Capital under Statute (REFCUS). The details of this adjustment are set out on page 18. We identified a number of disclosure errors within the Officers' Remuneration disclosure which are considered to be material by nature due to the sensitive nature of this information, as set out on page 18. Management has amended the financial statements for these issues.
Adjusted misstatements	Our audit identified five immaterial misstatements regarding valuation of council dwellings and classification of certain assets and liabilities, which management has amended in the financial statements. This has increased net assets and decreased the deficit on the provision of services by £4,767k. The misstatements identified have no impact on the General Fund or HRA balances at 31 March 2017. A few other presentational changes have been made to the financial statements as a result of the audit.
Unadjusted audit differences	Our audit identified four unadjusted audit differences in respect of NDR appeals provision, bank balances relating to schools converted to academies, fees and charges income recognised in 2016/17 that relates to the prior year and Section 106 developer contributions recognised as a liability when such contributions should have been accounted for as income. If corrected, these would increase net assets by £2,709k and decrease the deficit on the provision of services by £2,239k. If corrected, these would decrease the General Fund balance at 31 March 2017 by £1,769k.

SUMMARY

Control environment	Our audit identified no significant deficiencies in internal controls.

KEY MATTERS FROM OUR AUDIT OF USE OF RESOURCES	
Sustainable finances	Government continues to reduce funding for local government, and combined with additional pressures arising from demographic and other changes, this will have a significant impact on the financial resilience of the Council in the medium term. Whilst the Council has identified a significant funding gap, action is being taken to ensure the matter is addressed and the Council has a track record of achieving its financial plans. Therefore, whilst there is a recognised funding gap in the Medium Term Financial Plan (MTFP), we are satisfied that the Council is undertaking appropriate arrangements to manage this in a way that will ensure it remains financially sustainable over the period of the MTFP.

AUDIT OPINION	
Financial statements	Subject to the successful resolution of outstanding matters set out on page 5, which are largely procedural, we anticipate issuing an unmodified opinion on the financial statements for the year ended 31 March 2017.
Annual governance statement	We have no exceptions to report in relation to the consistency of the Annual Governance Statement with the financial statements or our knowledge.
Use of resources	Subject to the successful resolution of outstanding matters set out on page 5, we anticipate issuing an unmodified opinion on the use of resources for the year ended 31 March 2017.

OTHER MATTERS FOR THE ATTENTION OF THE AUDIT COMMITTEE	
Whole of Government Accounts (WGA)	We will complete our review of the WGA Data Collection Tool (DCT), after we have completed our audit of the financial statements. We will issue our opinion on the consistency of the DCT return with the audited financial statements before the 29 September 2017 statutory deadline.
Audit independence	Our observations on our audit independence and objectivity and related matters are set out in Appendix IV.
Audit certificate	We cannot issue our audit certificate until we have completed our work in respect of an objection received relating to the Council's use of Lender Option Borrower Option (LOBO) loans received in respect of the 2015/16 audit (which still remains open).

INTRODUCTION

PURPOSE AND USE OF THIS REPORT

We present our Audit Completion Report to the Audit Committee, which details the key findings arising from the audit for the attention of those charged with governance. It forms a key part of our communication strategy with you, a strategy which is designed to promote effective two way communication throughout the audit process.

As auditors we are responsible for performing our audit in accordance with International Standards on Auditing (UK & Ireland) which provide us with a framework which enables us to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management nor those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements and use of resources. As the purpose of the audit is for us to express an opinion on the financial statements and use of resources, 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.

This report has been prepared solely for the use of the Audit Committee. In preparing this report we do not accept or assume responsibility for any other purpose or to any other person.

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

AUDIT QUALITY

BDO is totally committed to audit quality. It is a standing item on the agenda of BDO's Leadership Team who, in conjunction with the Audit Stream Executive (which works to implement strategy and deliver on the audit stream's objectives), monitor the actions required to maintain a high level of audit quality within the audit stream and address findings from external and internal inspections. BDO welcome feedback from external bodies and is committed to implementing necessary actions to address their findings.

We recognise the importance of continually seeking to improve audit quality and enhancing certain areas. Alongside reviews from a number of external reviewers, the AQR (the Financial Reporting Council's Audit Quality Review team), QAD (the ICAEW Quality Assurance Department) and the PCAOB (Public Company Accounting Oversight Board who oversee the audits of US firms), the firm undertakes a thorough annual internal Audit Quality Assurance Review and as member firm of the BDO International network we are also subject to a quality review visit every three years. We have also implemented additional quality control review processes for all listed and public interest audits.

More details can be found in our latest Transparency Report at www.bdo.co.uk.

We have substantially completed our audit work for the year ended 31 March 2017, and anticipate issuing unmodified opinions on the financial statements and use of resources.

OUTSTANDING MATTERS

The following matters are outstanding at the date of this report. We will update you on their current status at the Audit Committee meeting at which this report is considered:

1. Internal quality control review process
2. Subsequent events review
3. Final review and approval of the financial statements
4. Management representation letter, as attached in Appendix VI, to be approved and signed

KEY AUDIT AND ACCOUNTING MATTERS

AUDIT RISKS

We assessed the following matters as audit risks as identified in our earlier Audit Plan dated 9 March 2017 and our Risk Update Letter dated 11 July 2017.
Below we set out how these risks have been addressed and the outcomes of our procedures.

Key: ■ Significant risk ■ Normal risk

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
1	**Management override of controls**	Auditing standards presume that a risk of management override of controls is present in all entities and require us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual. By its nature, there are no controls in place to mitigate the risk of management override.	Our response to this risk included: • testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements • reviewing accounting estimates for biases and evaluated whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud • obtaining an understanding of the business rationale for significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.	We have used data analytics software (BDO Advantage) to analyse the Council's ledger, and identify journal entries with characteristics which may be indicative of a higher level of management override risk. We have then carried out substantive testing in order to verify the appropriateness of these journals. Our audit work in relation to journals has not identified any significant issues. We have not found any indication of material management bias in accounting estimates. When considering the identified misstatement in respect of NDR appeals provision, to some extent management's estimate tends to be on the aggressive end of the spectrum, although not materially. Further details of our findings in respect of NDR appeals provision are set out on page 15. Our views on significant management estimates are included on the following pages. No unusual or transactions outside of the normal course of business were identified.

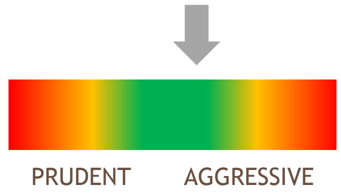
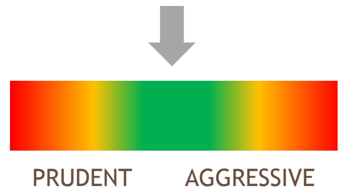
KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
2	**Revenue recognition**	Under auditing Standards there is a presumption that income recognition presents a fraud risk. For local authorities, the risks can be identified as affecting the accuracy and existence of income. In particular, we considered there to be a significant risk in relation to the existence (recognition) of fees and charges recorded in the CIES with a particular focus on year-end cut off as this is susceptible to manipulation for enhanced performance. Fees and charges revenue is generated from the raising of invoices and the collection of cash and direct payments arising from payments made for Council services. Therefore, there is an inherent risk in relation to the recognition point of such income.	We tested a sample of fees and charges to ensure income has been recorded in the correct period and that all income that has been recorded should have been recorded. We substantively tested an increased sample of fees and charges income streams from the ledger to supporting documentation to ensure that income recognised is valid.	Our testing identified that fees and charges income of £5.2k which relates to the prior year had been recognised in 2016/17 year. When extrapolated, this resulted in an error of £470k which has been included in the unadjusted misstatements schedule in Appendix I. No other issues have been identified by our testing of revenue from fees and charges.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
3	**Land, buildings, dwellings and investment property valuations**	Local authorities are required to ensure that the carrying value of land, buildings, dwellings and investment properties is not materially different to existing use value for operational assets, or fair value for surplus assets and investment properties, at the balance sheet date. The Council applies an annual revaluation process which is determined through consultation between the finance team and the valuation team. High value properties, and those which are expected to be subject to significant valuation movements, are revalued on an annual basis to provide assurance that carrying values are materially correct, with the remainder of non-material value assets revalued periodically (minimum of every five years). Operational asset valuations are undertaken by internal valuers. We consider there to be a risk over the valuation of land buildings, dwellings and investment properties where valuations are based on market assumptions or where updated valuations have not been provided for a class of assets at the year-end. (This has been increased from a normal risk to a significant risk due to volatility and uncertainty over market prices in the year and level of inherent uncertainty and judgement involved in the valuation of these assets).	We reviewed the instructions provided to the internal valuer and reviewed the internal valuer's skills and expertise in order to determine if we can rely on the management expert. We assessed whether the basis of valuation for assets valued in year is appropriate based on their usage, and whether an instant build modern equivalent asset basis has been used for assets valued at depreciated replacement cost. We reviewed the movements in valuations with other relevant market indices to assess the reasonableness of the valuations. We reviewed the significant assumptions used by the valuers for accuracy and reasonableness.	From our review of the instructions provided to the internal valuer and assessment of the expertise of the internal valuer, we are satisfied that we can rely on this work. We have reviewed a sample of in-year revaluations and we are satisfied that the valuation bases used are appropriate. However, we identified that the internal valuer has not applied the correct adjustment factor when arriving at Existing Use Value - Social Housing (EUV-SH) for council dwelling. The Department for Communities and Local Government (DCLG) updated the adjustment factors which should be used when valuing council dwellings, with effect from April 2016. The adjustment factor for South East region, where Medway Council is located, has increased from 32% to 33%. The internal valuer had only applied a 32% adjustment factor when arriving at EUV-SH for council dwellings, which resulted in an understatement of the value of council dwellings by £4,767k with an overstatement of the deficit on the provision of services by the equal amount. As the amount is reversed to the Capital Adjustment Account as part of statutory adjustments, there is no impact on the General Fund balance or HRA balance at 31 March 2017. Management has amended the financial statements for the above issue. We are satisfied that overall movement in property values in respect of council dwellings and other land and buildings is in line with relevant market indices. Our review of the reasonableness of valuation assumptions applied is noted on the following page.

KEY AUDIT AND ACCOUNTING MATTERS

SIGNIFICANT ACCOUNTING ESTIMATES		
Land, buildings, dwellings and investment property valuations		
ESTIMATE	**HOW RISK WAS ADDRESSED BY OUR AUDIT**	**AUDIT CONCLUSION**
Land and buildings are valued by reference to existing use market values Dwellings are valued by reference to open market value less a social housing discount Investment properties are valued by reference to highest and best use market value Some specialist buildings are valued at depreciated replacement cost by reference to building indices	**Council dwellings** For council dwellings, the internal valuer has applied a flat rate increase ranging from 12% to 15% depending on the property type and location, which is based on the valuer's market research. This resulted in an overall revaluation gain of £17.4 million after accounting for stock movements, which represents an average increase of 12.4%. We have compared this to the house price increase for South East region given in the Gerald Eve Public Sector Consultants' report, who acts as auditor's expert in respect of valuation of properties, which shows an increase of 3.8% over the same period. However, Land Registry data for the Medway local authority area shows an increase in house price over the period of 10.6%. Discussions with the valuer revealed that there is a significant variation in market conditions within the South East region, and that the Council's dwellings tend to be located within more advantageous areas, given its close proximity to London, giving higher demand for houses within the local authority area. Had the value of council dwellings been increased at a rate of 10.6% as oppose to 12.4%, this would have reduced the overall valuation by £2.6 million. As such, we have concluded that the increase of 12.4%, whilst on the aggressive side, results in an overall valuation which falls within a reasonable range when compared to Land Registry data and resulted in a materially correct valuation of council dwellings.	
	Other land and buildings (including specialist buildings) The overall value of other land and buildings has increased by £3.8 million, which represents an average increase of 0.95%. IPD regional capital growth indices show regional decrease of 0.08% for the period Q1 2016 to Q1 2017. Discussions with the valuer revealed that depreciated replacement cost (DRC) method has been applied for most of the other land and buildings revalued during the year and the increase in valuation reflects the increase in build cost over the period. We have tested a sample of assets revalued during the year with a particular focus on individual movements which appeared unusual. We reviewed DRC calculations by corroborating floor area data to the Council's internal records and build cost information to the same data from BCIS and challenged the assumptions being used where they appeared unusual, and we are satisfied that overall the Council's valuations fall within a reasonable range and resulted in a materially correct valuation of other land and buildings.	
	Investment properties Investment properties have seen an overall increase in valuation of £2.8 million (41.4%), of which £2.4 million was attributable to Gillingham Business Park. Discussions with the valuer revealed that the increase in valuation was due to increased rent levels and occupancy which resulted in higher rental values for these properties. We reviewed rental yield on the Council's investment properties. The current valuation gives an overall rental yield which is within a reasonable range when compared to regional rental yield information and we are therefore satisfied that valuation of investment properties is reasonable.	

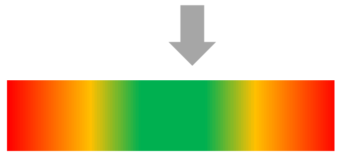
KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
4	Pension liability assumptions	The net pension liability comprises the Council's share of the market value of assets held in the Kent County Council Pension Fund and the estimated future liability to pay pensions. An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation. Management has agreed the assumptions made by the actuary to support the estimate and these are disclosed in the financial statements. There is a risk the valuation is not based on accurate membership data or uses inappropriate assumptions to value the liability.	We agreed the disclosures to the information provided by the pension fund actuary. We requested assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary. We checked whether any significant changes in membership data were communicated to the actuary. We reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data. This included review of the PwC consulting actuary report commissioned by the NAO on behalf of all local authority auditors for the review of the methodology of the actuary and reasonableness of the assumptions.	We identified some minor presentational issues within the pension note for which management has amended the financial statements. We did not identify any issues regarding the accuracy and completeness of data provided by the Fund to the actuary. We confirmed that there have been no events which resulted in a significant change in membership data during the year. Our review of the reasonableness of assumptions used to calculate the present value of future pension obligations is noted in the following pages.

KEY AUDIT AND ACCOUNTING MATTERS

SIGNIFICANT ACCOUNTING ESTIMATES

Pension liability assumptions

ESTIMATE	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT CONCLUSION
The key assumptions include estimating future expected cash flows to pay pensions including inflation, salary increases and mortality of members; and the discount rate to calculate the present value of these cash outflows	The gross pension liability of the Council has increased by £135.9 million, from £656.8 million to £792.7 million. This is principally due to a reduction in the discount rate used to value future liabilities (from 3.7% to 2.8%) along with an increase to the pension increase rate (from 2.4% to 2.7%). We have compared below the actual assumptions used by the actuary to those suggested by PwC as acceptable.	

	Actual used	Acceptable range (PwC)	PwC assessment of actuary range to market expectations
RPI increase	3.6%	3.5-3.6%	Top of expected range (see our assessment on the following page)
CPI increase	2.7%	2.6-2.7%	Top of expected range (see our assessment on the following page)
Salary increase	4.2%	-	Employer specific (this is long term salary increase and reasonable in context of RPI and CPI)
Pension increase	2.7%	2.6-2.7%	Top of expected range (derives from the RPI above)
Discount rate	2.8%	2.55-2.75%	Above expectations (does not reflect full shape of the underlying yield curve or timing of the benefit payment – see assessment on the following page)
Mortality:			
Retiring today			
- Male	23.0 years	21.4-24.4	Reasonable
- Female	25.0 years	24.2-26.0	Reasonable
Retiring in 20 years			
- Male	25.1 years	23.5-26.6	Reasonable
- Female	27.4 years	26.5-28.3	Reasonable
Commutation	50%	50%	Reasonable

Except for discount rate assumption, all other assumptions used fall within the reasonable range for the actuary as per the PwC report. Our assessment of the discount rate assumption is set on the following page.

KEY AUDIT AND ACCOUNTING MATTERS

SIGNIFICANT ACCOUNTING ESTIMATES	
Pension liability assumptions	
ESTIMATE	**HOW RISK WAS ADDRESSED BY OUR AUDIT**
Continued	PwC concluded: *The discount rates proposed at all durations fall outside of the top end of our expected ranges at 31 March 2017. Individually, we might view these assumptions to be optimistic, and auditors may wish to consider whether a lower discount rate (for example a reduction of 0.1%) would lead to materially different accounting entries for their employers. Auditors may be able to gain comfort that the assumptions in aggregate (i.e. considering all the financial and demographic assumptions together) will result in liability figures that are not materially misstated at 31 March 2017, albeit the chosen assumptions will be disclosed in the pensions note and thus subject to external scrutiny.* In response, we commissioned a separate review from an independent actuary (Broadstones) to review the strength of the assumptions applied and the potential impact on the calculation of the liability. **Discount rates** This review concluded that, while the discount rate range applied was high, the approach to obtain a single point from the yield curve is an acceptable method. A benchmarking exercise found that a rate up to 2.80% approached the 95th percentile (normal range 2.55% - 2.75%), and that the rate applied for this pension fund at 2.80% was above average but within a normal range. An increase of 0.1% in the discount rate would decrease the liabilities by 2%. **Inflation rates** A review of the RPI inflation assumptions concluded that the rate applied was high, and followed the same methodology as the discount rate curve methodology in not adjusting for an inflation risk premium. A benchmarking exercise found that a rate up to 3.60% approached the 95th percentile (normal range 3.28% - 3.48%), and that the rate applied for this pension fund at 3.60% was above a normal range. An increase of 0.1% in the inflation rate would increase the liabilities by 2%.

KEY AUDIT AND ACCOUNTING MATTERS

ESTIMATE	HOW RISK WAS ADDRESSED BY OUR AUDIT
Continued	**Overall impact of assumptions** PwC concluded that, overall, Barnett Waddingham liabilities calculations tended to be generally 'strong' (i.e. placing a higher value on the liabilities) and that in combination the higher discount rate and higher inflation assumptions may result in an acceptable valuation. The Broadstone review concurred with this view and stated that reducing both the discount rate and inflation assumptions would bring these into line with general expectations, but would not lead to materially different liability calculation overall. **Conclusion** The impact of the higher discount rate and inflation rates tend to counteract each other and the overall liability calculation is reasonable.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
5	Changes in presentation of the financial statements	The 2016/17 Code requires a change to the presentation of some areas of the financial statements. This includes: • Change to the format of the Comprehensive income and Expenditure Statement (CIES) • Change to the format of the Movement in Reserves Statement (MiRS) • New Expenditure and Funding Analysis (EFA) note • Change to the Segmental Reporting note • New Expenditure and Income analysis note. This requires a restatement of the 2015/16 CIES. We identified a risk that these presentational changes would not be correctly applied in the financial statements.	We reviewed the draft financial statements and checked these against the CIPFA Disclosure Checklist to ensure that all of the required presentational changes have been correctly reflected within the financial statements. We reviewed the restatement of the comparative 2015/16 information to ensure that this is presented consistently with the current year basis.	We are satisfied that the new format and structure of the CIES is appropriate, and is consistent with internal reporting. We found that restatement of the 2015/16 CIES is accurate and this has been prepared consistently with the current year basis. Our testing identified that the new format and structure of the MiRS is appropriate. We are satisfied that new notes in respect of Expenditure and Funding Analysis, Segmental Reporting and Expenditure and Income Analysis have been properly prepared in line with requirements of the Code. By introducing these notes, CIPFA aimed to provide a bridge between the information reported to the Members/management and the information reported in the CIES. The Council's original draft accounts included the 5 column analysis that is included in the final accounts. However, this did not comply with the current presentation suggested within the CIPFA Code. During the course of the audit, at a national level, it was recognised that the aim of the disclosure was not, in fact, fully achieved by that CIPFA guidance. As a consequence of this development, we suggested that the original analysis be re-instated. We wish to highlight the Council's finance team's pro-activity in this area as an area of notable good practice. We identified some minor corrections to the information presented on these notes. Management has updated the financial statements for these issues.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
6	Non-domestic rates appeals provision	Billing authorities are required to estimate the value of potential refund of business rates arising from rate appeals, including backdated appeals. The Valuation Office Agency (VOA) provides information regarding the appeals currently being assessed and settled. The Council has engaged an external consultancy firm, Analyse Local to assess the potential rateable value loss and provisions thereon on outstanding appeals. Estimation of potential loss of rateable value is considered to be a significant accounting estimate and this involves assumptions that are uncertain by nature. We considered there to be a risk in relation to the estimation of the provision due to potential incomplete data and assumptions used in calculating the likely success rate of appeals. We identified through our preliminary analytical review of the draft financial statements that no additional appeals provision has been recognised during the year. The variance identified was outside of our expectation and we have elevated the risk associated from 'normal' to 'significant'.	We agreed the underlying appeals information to the VOA reports of outstanding appeals. We agreed the accuracy of the information used to calculate the success rate from settled appeals. We reviewed the estimates provided by external expert and assessed the significant assumptions and methods used.	We identified that no movement in appeals provision during the year has been recognised in the financial statements and the total provision in the Collection Fund and Medway Council's share remain at £12.1m and £5.9m respectively. The Council obtained an estimate of likely rateable value loss and provision thereon in respect of outstanding appeals from the external consultant, Analyse Local (AL). The report showed an estimated rateable value loss of £11.0m on the total current rateable value of £188.6m on outstanding appeals. AL assessed the gross provision on the above rateable value loss to be £17.9m. When discounts and reliefs are taken account of (which is estimated to be approximately 15% based on a calculation performed by the Council), the provision required at 31 March 2017 is £15.2m, which is £3.2m higher than the total provision recognised in the Collection Fund. The report provided by AL has been reviewed by management, who have concluded, as they did in 2015/16, that the external consultant was overly pessimistic in their calculation of provision. Management has concluded that the existing balance sheet provision for appeals is sufficient and no further provision is required. We used VOA data to calculate the success rate from settled cases and we concluded that the estimate provided by external consultants was reasonable (please see details on the following page). Therefore, we have concluded that the appeals provision has been understated by £3,152k of which Council's share of 49% equates to £1,544k. This has been included as an unadjusted audit difference at Appendix I. We agreed the underlying appeals information to the VOA reports of outstanding appeals.

KEY AUDIT AND ACCOUNTING MATTERS

SIGNIFICANT ACCOUNTING ESTIMATES

Non-domestic rates appeals provision

ESTIMATE

Estimate of refunds for successful NDR appeals

HOW RISK WAS ADDRESSED BY OUR AUDIT

Management uses an external consultant, Analyse Local, to provide an estimate of likely rateable value loss and required provision thereon. However, as noted above, management has decided not to adopt the estimates provided by external consultants in the current year.

In order to assess the reasonableness of the potential rateable value loss we have obtained a data download (IPP List) from VOA which included results of over 6,000 historical appeals from 2006 and the information about original rateable value and the rateable value decided as a result of such appeals, including subsequent withdrawals.

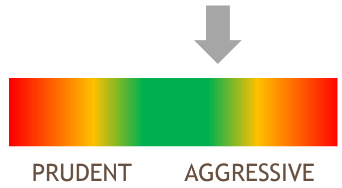
These appeals showed that, on average, the rateable value loss was 5.21% of the original rateable value, as set out on the table below. When this percentage is applied to the current rateable value of outstanding appeals (£188.6m), this gives a potential rateable value loss of £9.8m. Applying average NDR multiplier (0.45) and average number of years the claim would be backdated (4 years) gives appeals provision of £15.0m after adjustments for discounts and reliefs (15%).

This amount is in line with the estimate provided by Analyse Local and we therefore consider that the NDR appeals provision has been potentially understated by £3.2m in the Collection Fund. The Council’s share of this provision (49%) has been understated by £1.5m. This has been included as an unadjusted audit difference at Appendix I.

Settlement Type	No. of appeals	Original RV (£000)	New Adopted RV (£000)	RV loss (£000)	RV loss (%)
Agreed	1,791	182,108	158,963	23,145	12.7%
Dismissed	905	53,283	53,283	0	0%
Well Founded	42	1,031	47	984	95.4%
Decision by VT	49	3,106	1,534	1,572	50.6%
Withdrawn	3,532	253,891	253,891	0	0.0%
	6,319	493,419	467,718	25,701	5.21%

(The above numbers are based on VOA data download as at 31/03/17).

AUDIT CONCLUSION



KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
7	Consideration of related party transactions	We are required to consider if the disclosures in the financial statements concerning related party transactions are complete and accurate, and in line with the requirements of the accounting standards. There is a risk that related party transactions disclosures are omitted from the financial statements, or do not accurately reflect the underlying related party transaction.	We reviewed the related party transactions identification procedures in place and reviewed relevant information concerning any such identified transactions. We also carried out Companies House searches for undisclosed interests. We discussed with management and reviewed members' and senior management declarations to ensure there are no potential related party transactions which have not been disclosed.	We identified no undisclosed related party transactions within the draft financial statements. Our audit identified that certain organisations disclosed as related parties in the draft financial statements did not meet the definition of related parties as per accounting standards. Management has amended the financial statements for these issues.

KEY AUDIT AND ACCOUNTING MATTERS

OTHER ISSUES

We comment below on other issues identified in the course of our audit, of which we believe you should be aware:

	AUDIT AREA	AUDIT FINDINGS
8	Officers' Remuneration	We identified a number of disclosure errors within the Officers' Remuneration note as follows: • Two senior officers receiving total remuneration (including pension contribution) of between £60k and £80k had been omitted from the disclosure note. • Two senior officers received termination benefit and these payments had been omitted from the total remuneration disclosed for the two senior officers. • For two senior officers, special allowances received had been incorrectly disclosed as expenses payments. These amounts were also included within the Salaries, Fees and Allowances column. • One senior officer's remuneration was incorrectly understated by £1k. • One senior officer who received remuneration greater than £150,000 had not been named in the disclosure note, as required by the Code and the Regulations. The Code requires authorities to disclose the number and total value of exit packages agreed during the year. We identified that a number of exit packages were missing from the disclosure note as a result of the report used not picking up all relevant termination benefits. We have included a management recommendation in respect of this matter within Appendix II. Given the sensitivity of this information the disclosure is considered to be material by nature. Management has amended the financial statements for the above issues.
9	Prior Period Adjustment	A prior period adjustment has been made to derecognise two school properties with a total net book value of £52 million at 31 March 2017. These properties were constructed for Strood Academy and Brompton Academy, and cost incurred in constructing the properties over the past years had been capitalised within property, plant and equipment (PPE). No lease agreement has been signed in respect of these properties due to some unresolved legal matters. We understand that lease agreements are currently being finalised. The accounting treatment in respect of two properties has been reconsidered in the current year, and we concluded that expenditure incurred in constructing the properties should be accounted for as revenue expenditure funded from capital under statutes (REFCUS). This is on the basis that the properties which were constructed were intended for transfer to the Academies. There was therefore no future economic benefit to the Council, which is a requirement for recognition of PPE. This is further supported by repairs and insurance of these properties being borne by two Academies, and that the Academies already recognise the assets on their balance sheets. Management have amended the financial statements to derecognise these properties from the balance sheet. In accordance with the Code and applicable financial reporting standards, a third balance sheet has been prepared showing restated opening balances for the 2015/16 financial year. We are satisfied that prior period restatement has been correctly made and appropriate disclosures have been made in the financial statements.

	AUDIT AREA	AUDIT FINDINGS
10	Investment	We identified that an investment of £4.5m with a maturity date of 10 July 2017 was incorrectly classified within Long Term Investments line in the Balance Sheet. As the maturity date falls within less than one year from the current balance sheet date, the amount should be classified within Short Term Investments. The financial statements were amended to correct this issue.
11	NDR Appeals Provision	Within the draft provisions note, we noted that movements in year on the NDR appeals provisions have been shown incorrectly. As discussed on key audit and accounting matter 6 above, the Council has not recognised any movement in NDR appeals provision during the year. However, the disclosure note included an additional provision made during the year of £6.2m with the same amount being disclosed against unused amounts reversed line. We also identified that the short term and long term elements of NDR appeals provision were incorrectly classified in the draft accounts. This resulted in short term provisions being understated by £1.5m with long term provision being overstated by the same amount. Management has amended the financial statements for the above issues. We note that the Council's financial system, Integra does not include information about NDR appeals settled during the year. This is because the amounts settled in respect of successful appeals are set off against the amounts due on Northgate feeder system. In respect of provisions, the Code requires disclosure of amounts used (i.e. incurred and charged against the provision) during the period, which is not disclosed in the draft provisions note. Whilst the amount is likely to be not material, we have included a recommendation on Appendix II in respect of this matter.
12	School Balances	During our review of the cash and bank balances, we noted that a number of cash balances were in the name of schools which had converted to academy status prior to 31 March 2017, and therefore these balances do not belong to the Council. Total amount of cash balances relating to schools converted to academy status was £534k, of which £309k was a loan given to an academy which is repaid on an annual basis, hence should be classified as receivables. The remaining amount of £225k should be written off to expenses during the year. An unadjusted misstatement has been raised as detailed in Appendix I. We have also included a control recommendation in Appendix II to ensure a process is in place to identify any academy cash balances prior to closing the accounts.
13	Financial Instruments	We identified a number of disclosure issues within the financial instruments disclosure note. These were as follows: • Housing benefit overpayment of £11.9m had been included within the financial instruments disclosure, which should be excluded as does not meet the definition of financial instruments. • Bad debts provision in respect of general fund debtors and HRA debtors of £2.5m and £509k respectively, had been excluded from the workings. These amounts should be included as impairment allowances as required by the Code. • Few other minor presentational issues were also identified within the disclosure note. The Financial statements were amended for the above issues.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	AUDIT FINDINGS
14	Capital Grants Receipts in Advance (Section 106 Contributions)	Within the draft financial statements the Council has recognised Capital Grants Receipts in Advance of £4,545k, which includes Section 106 (s.106) developer contributions of £4,478k. Developers are asked to provide contributions for infrastructure where development will have a significant impact on the local area. A s.106 deed is signed between the Council and the developer which provides that contributions received by the Council should be spent within a period of 10 years and any unspent amount at the end of this period is returned to the developer on request. The Code specifies that grants and contributions shall not be recognised until there is reasonable assurance that the authority will comply with the conditions attached to them. In line with this principle, the Council recognises s.106 contributions in the CIES only when a project to spend these contributions was identified or when actual expenditure was incurred. Management's view is that 10 year period to spend contributions should be regarded as an unmet condition until a project is agreed or actual expenditure is incurred, until such time these contributions should be recognised in liabilities. The Code clarifies the above matter and states that "A grant, contribution or donated asset may be received subject to a condition that it be returned to the transferor if a specified future event does or does not occur. In these cases, a return obligation does not arise until such time as it is expected that the condition will be breached and a liability is not recognised until that time. Such conditions do not prevent the grant, contribution or donated asset being recognised as income in the CIES". The Code Guidance Notes further clarify the above matter which states that authorities are required to analyse the substance of their particular agreements to determine whether income should be recognised in the CIES or a liability should be recognised in the Balance Sheet. In our view, the general time limit stipulation on s.106 contributions is not a condition that prevents recognition as income where the local authority has plans that it intends to spend the money on the general requirements of the s.106 agreement. The time limit is not a 'condition' unless management believes it will not be able to spend the grant within the time limit. The 10 year period is considered to be a sufficiently long period within which the Council is more likely to spend these contributions. Our review of the historical cases revealed that there were no instances whereby the Council had to return contributions received in the past. Therefore, in our view, the substance of these contributions is that they are not liabilities but usable capital reserves. Therefore, we consider that s.106 contributions should be recognised in the CIES on receipt and transfer from general fund to capital grants unapplied account (via MiRS) until they are spent at which time they transfer to capital adjustment account. The Financial statements will not be amended for the above issue. Whilst we recognise the subjective nature of accounting treatment in respect of s.106 contributions and varying accounting treatments across different Local Authorities in respect of these contributions, for this Authority we consider it is more appropriate to recognise these contributions in the CIES on receipt. Consequently, we have included this as an uncorrected misstatement within the Appendix 1 (see journal 4).

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	AUDIT FINDINGS
15	Surplus Assets	The Code states that assets that are not being used to deliver services, but which do not meet the criteria to be classified as either investment properties or non-current assets held for sale, should be classified as surplus assets. The property valuation report provided by the internal valuer has identified some assets as being surplus assets. However, the draft financial statements did not include any surplus assets. We have therefore requested management to identify any other surplus assets which were not revalued during the year. From our discussions with Finance and Property teams of the Council, we identified that assets with a total value of £752k would be classified as surplus assets. Management has amended the financial statements to reclassify this amount from other land and buildings to surplus assets.
16	Other disclosure issues	We identified a number of other disclosure issues within the draft financial statements as follows: • An adjustment between operating cash flows and investing cash flows in respect of capital expenditure funded from capital grants in the Statement of Cash Flows was incorrectly stated. The correct amount of £17m has been incorrectly transposed as £17k. • Chargeable dwelling figures in respect of council tax within notes to the Collection Fund Statement have not been updated and the figures disclosed were prior year numbers. • An explanatory paragraph included within Expenditure and Income Analysed by Nature note relates to Expenditure and Funding Analysis note. • Total amounts within the disclosure in respect of rolling programme for the revaluation of property, plant and equipment did not agree to the cost/valuation totals within the property, plant and equipment note. • The disclosure of vacant possession value of dwellings within the authority's HRA as at 1 April 2016 was incorrectly disclosed. • Capital Expenditure and Capital Financing note did not include a disclosure in respect of opening and closing capital financing requirements (CFR) as required by the Code. • Non material accounting policies in respect of foreign currency translations, long term contracts, CRC scheme and contingent assets have been included in the financial statements. • Members' allowances disclosure note included employer NIC which is not required by the Code and not a part of members' allowances. • Within the revaluation reserve note, the amounts disclosed for accumulated gains on assets sold or scrapped and difference between fair value depreciation and historical cost depreciation did not agree to the underlying accounting records. The Financial statements have been amended to correct for the above issues.

OTHER REPORTING MATTERS

We comment below on other reporting required to be considered in arriving at the final content of our audit report:

	MATTER	COMMENT
17	The draft financial statements, within the Statement of Accounts, was prepared and provided to us for audit on 2 June 2017. 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.	The Finance team has made a satisfactory achievement by completing the draft financial statements and making them available for audit well before the deadline of 30 June. All required information was made available to us by the target dates.
18	We are required to review the draft Annual Governance Statement and 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.	We have no matters to report.
19	We are required to read all the financial and non-financial information in the Narrative Report to the financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit.	Our work identified a number of minor corrections to the narrative report which have been adjusted in the financial statements.

CONTROL ENVIRONMENT

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

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

We note that the Council's internal audit function has issued a number of observations and recommendations on the Council's control environment during 2016/17. We have not repeated these recommendations in this report unless we consider them to highlight significant deficiencies in control which we are required to report to you.

We are not aware of any significant deficiencies in the Council's internal controls in 2016/17.

We have identified other non-significant deficiencies in controls which have been discussed with management and included in the action plan at Appendix II.

WHOLE OF GOVERNMENT ACCOUNTS

We comment below on other reporting required:

	MATTER	COMMENT
20	For Whole of Government Accounts (WGA) 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 we are required to perform tests with regard to the Data Collection Tool (DCT) return prepared by the Authority 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 DCT return with the audited financial statements, and reviewing the consistency of income and expenditure transactions and receivables and payable balances with other government bodies.	Local authorities were required to submit the unaudited DCT to HM Treasury and auditors by 7 July 2017. The Council was unable to meet this deadline. Our review of the Council's WGA Data Collection Tool (DCT) is in progress. We will complete our review of the WGA Data Collection Tool (DCT), after we have completed our audit of the Council's financial statements. We intend to issue our opinion on the consistency of the DCT return with the audited financial statements before the 29 September 2017 statutory deadline.

USE OF RESOURCES

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). This is based on the following reporting criterion:

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

There are three sub criteria that we consider as part of our overall risk assessment:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties.

We reported our risk assessment, which included use of resources significant risks, in the 2016/17 Audit Plan issued on 9 March 2017. We have since undertaken a more detailed assessment of risk following our completion of the interim review of financial controls and review of the draft financial statements, and we have not included any additional significant risks.

We report below our findings of the work designed to address these significant risks and any other relevant use of resources work undertaken.

Key: ■ Significant risk ■ Normal risk

USE OF RESOURCES

RISK AREA		RISK DESCRIPTION AND WORK PERFORMED	AUDIT FINDINGS AND CONCLUSION
1	Sustainable finances	Government continues to reduce funding for local government, and combined with additional pressures arising from demographic and other changes, this will have a significant impact on the financial resilience of the Council in the medium term. We have reviewed the Council's Medium Term Financial Plan (MTFP) to assess the reasonableness of assumptions used and how the Council is addressing financial pressures. We ensured that the MTFP had appropriately dealt with the pressures with respect to Children's and Adult Services. We reviewed the arrangements in place for closing the budget gap in the medium term. **Financial performance 2016/17** The Council's revised budgeted net expenditure for 2016/17 was £309.1 million. The final outturn for the year was close to breakeven with a modest underspend of £371k. Children & Adults budget was overspent by £2.0 million which was offset by underspend on Regeneration, Culture, Environmental and Transformation budget by £1.5 million and Business Support budget £1.3m million. Adults overspends were driven by pressure from disability placement expenditure, and children's social care budget was adversely affected by the increase in external placement costs. School related budget was overspent largely due to the pressure from school transport driven by increased numbers. **Medium Term Financial Plan assumptions** The Medium Term Financial Plan (MTFP) was updated in September 2016 which showed a budget gap of £11.7 million in 2017/18, £10.5 million in 2018/19 and £14.6 million in 2019/20. Subsequent to this, in February 2017 the Council has set a balanced budget for 2017/18. The Council has introduced some significant savings proposals within its current MTFP which includes £7 million savings per annum by 2018/19 through digital transformation, additional savings of £3.9 million by 2017/18 through diagnostic review of adult social care, £3 million from a review of the minimum revenue provision and a number of other measures including outsourcing and reduction in expenditure. We have considered reasonableness and viability of these saving plans alongside their up to date progress.	We are satisfied that the Council has adequate arrangements for setting and monitoring financial budgets, and that it has clearly identified its funding gap and savings requirements through to 2020. Whilst the Council has identified a significant funding gap, action is being taken to ensure the matter is addressed and the Council has a track record of achieving its financial plans. Sufficient reserves and balances are available to support the Council's services in the medium term, should there be under performance against savings plans. Therefore, while there is a recognised funding gap in the MTFP, we are satisfied that the Council is undertaking appropriate arrangements to manage this in a way that will ensure it remains financially sustainable over the period of the MTFP.

USE OF RESOURCES

RISK AREA	RISK DESCRIPTION AND WORK PERFORMED	AUDIT FINDINGS AND CONCLUSION
Sustanable finances (continued)	Much of the savings from digital transformation is expected over the coming years and expected savings from this in 2016/17 was £638k of which £250k has been delivered. Under achievement in the year is largely due to delay in implementation and the results reflect half year savings although budgeted for full year savings. The expected savings from digital transformation in 2017/18 is £1.6 million, of which £0.5 million has been achieved year to date (July 2017). Although, the Council is on target to achieve budgeted savings it is challenging to deliver full expected savings over the remaining period of MTFP. We have reviewed the Council's annuity based revised minimum revenue provision calculations and these have delivered planned £3 million savings. **Financial performance 2017/18** Financial outturn for Q1 2017/18 shows that forecast overspend of £1.9 million, although management action plans are being formulated and management anticipate that this figure will be mitigated further as the year progresses. Forecast shows that Children and Adults services will overspend by £320k for the year. The Government has allocated additional funding for social care which will reduce the pressure on adults social care budget. In 2017/18, the Council expect additional £3.9 million social care funding. **Reserves and balances** The Council continues to hold significant balances with earmarked revenue reserves at £17 million, a General Fund balance of £5 million and an HRA balance of £3.6 million. However, earmarked revenue reserves have significantly decreased by £14.6 million during the year due to use of these reserves to fund planned capital and revenue budget requirements in the year. The 2017/18 budget assumes a planned draw from reserves of £3.0 million to support revenue expenditure, and a further draw of £13.4 million to support capital and other regeneration schemes over the period of MTFP. There is little margin available in reserves and balances to support any further revenue budget overspends or slippage on savings plans and management will need to revisit how these reserves are being utilised in the event of continued pressures on budgets.	

APPENDICES

APPENDIX I: 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, and in aggregate, on the financial statements.

ADJUSTED AUDIT DIFFERENCES

A prior period adjustment has been made to derecognise two properties which had been capitalised within property, plant and equipment with a value of £50.94 million at 31 March 2017. These properties had been built for two Academies which should have been accounted for as Revenue Expenditure Funded from Capital under Statute (REFCUS). The details of this adjustment are set out on page 18. This adjustment has no impact on the General Fund or HRA balances at 31 March 2017.

Our audit identified five other immaterial misstatements regarding valuation of council dwellings and classification of certain assets and liabilities, which management has amended in the financial statements. This has increased net assets and decreased the deficit on the provision of services by £4,767k. The misstatements identified have no impact on the General Fund or HRA balances at 31 March 2017.

UNADJUSTED AUDIT DIFFERENCES

There are four unadjusted audit differences identified by our audit work. If corrected, these would increase net assets by £2,709k and decrease the deficit on the provision of services by £2,239k.

There are also two misstatements carried forward from the previous year that impact on the underlying reported deficit for the current year. These amounts remain misstatements with regard to reporting in year financial performance, but are not misstatements at the year end and cannot be corrected as these relate to previous years. Overall, the impact of prior year misstatements on current year performance would reduce the reported underlying deficit for the current year by £4,622k.

You consider these identified misstatements to be immaterial in the context of the financial statements taken as a whole. We concur with this judgement however we also request that you correct them even though not material.

APPENDIX I: AUDIT DIFFERENCES

		INCOME AND EXPENDITURE		STATEMENT OF FINANCIAL POSITION	
		DR	CR	DR	CR
	£'000	£'000	£'000	£'000	£'000
Deficit on the provision of services before adjustments	34,907				
DR Taxation & Non-specific Grant Income (NDR Income)	1,544	1,544			
CR NDR Provision					1,544
(1) Being the potential understatement of NDR appeals provision - Medway Council's share					
DR Receivables				309	
DR Expenses (CIES)	225	225			
CR Cash and Bank					534
(2) Being the impact of cash balances relating to schools which had converted to academy status prior to 31 March 2017					
DR CIES Income - Children's and Adults	470	470			
CR General Fund B/F Balance					470
(3) Being fees and charges income recognised in 2016/17 year which relates to the prior year (extrapolated error)					

APPENDIX I: AUDIT DIFFERENCES

		INCOME AND EXPENDITURE		STATEMENT OF FINANCIAL POSITION	
		DR	CR	DR	CR
	£'000	£'000	£'000	£'000	£'000
DR Grants receipts in advance - capital				4,478	
CR Taxation and non-specific grant income	(4,478)		4,478		
DR General fund				4,478	
CR Capital grants unapplied					4,478
(4) Being the recognition of Section 106 contributions received in the CIES and subsequent transfer from General Fund to Capital Grants Unapplied via MiRS as required by the Code					
TOTAL UNADJUSTED AUDIT DIFFERENCES	**(2,239)**	**2,239**	**4,478**	**9,265**	**7,026**
Deficit on provision of services if adjustments accounted for	32,668				

IMPACT ON GENERAL FUND AND HRA BALANCES	GENERAL FUND BALANCE £000s	HRA BALANCE £000s
Balances before adjustments	(5,000)	(3,618)
Adjustments to CIES above	(2,239)	-
Adjustments to B/F Balances	(470)	
Adjustments via movement in Reserves Statement	4,478	-
BALANCES AFTER ADJUSTMENTS	**(3,231)**	**(3,618)**

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

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

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
ANNUAL REPORT AND ACCOUNTS					
Use of management expert for NDR appeals provision	The Council engages external consultants, Analyse Local to provide estimates of likely rateable value loss for outstanding NDR appeals and provision thereon. In the prior year, management concluded that the consultant was overly pessimistic in their estimates and management assessed that 50% of the estimated amounts provided was reasonable. In 2016/17, management did not use the estimated amounts provided by the consultant as it concluded that the existing provision was reasonable and no additional provision was required.	We recommend that management reassess the work of external consultant to determine whether they can provide a reasonable estimate of NDR appeals provision to be included in the financial statements. This can be performed by a retrospective review of cases settled and assessing whether estimates provided by the consultant were reasonable against the actual amounts decided upon.	Agreed.	Jon Poulson, Head of Revenues & Benefits	Complete by 31 March 2018
NDR appeals provision - settlements made during the year	We identified that Council's financial system, Integra does not provide information about NDR appeals settled during the year. This is due to the settlements amounts are offset against the amounts due in Northgate feeder system. As a result of this, key financial information required for the purpose of preparation of financial statements is not available and consequently no required information is disclosed in the financial statements. This information is also relevant for informed management decisions about the NDR income.	We recommend that a process is put in place to identify actual settlements made during the year so that required information is readily available for the financial statements purpose.	Agreed that a process is put in place to identify actual settlements but this would ordinarily sit outside the Council's financial system.	Jon Poulson, Head of Revenues & Benefits	Complete by 31 March 2018

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
ANNUAL REPORT AND ACCOUNTS					
Charging VAT on income invoices	During the course of our audit we note that no VAT has been charged on ICT and payroll fees invoiced to Medway Commercial Group, a non material subsidiary company owned by the Council.	We recommend a process is put in place to identify all vatable services and ensure VAT is appropriately charged on all chargeable income streams.	A review of the process will be undertaken to see if a separate check can be incorporated as the invoice is raised.	Gary Thomas, Head of Finance Operations	Completed by 1st November 2017
Car provision and private medical insurance	The Council pays an annual special allowance to senior officers in respect to car provision and private medical insurance. The payment varies depending on seniority of the officer. These amounts are disclosed within the Councils pay policy. We note that the amounts paid to senior officers did not agree to the pay policy (amounts paid were approximately £100 higher than the amounts per the policy). This was due to the policy not being updated for the cost of living allowance (COLA).	It is recommended that pay policy is updated for the correct amounts payable to senior officers and ensure that the amounts paid are agreed to the pay policy.	Agreed, the policy will be amended accordingly.	Carrie McKenzie, Assistant Director Trans-formation	Complete by 31 March 2018
Reconciliation of school bank accounts	A cash advance of £371k given to one school in the prior year has been incorrectly posted to another school. This has been identified in 2016/17 year and included as a reconciling item on the bank reconciliation. However, this had not been corrected on the ledger.	Ensure all school bank accounts are reconciled on a timely manner and any errors identified are corrected on a timely basis.	School bank accounts are reconciled at least twice a year, with errors corrected in year wherever possible.	Maria Beaney, Finance Business Partner	Complete by 31 March 2018
Disclosure of exit packages	As set out on page 19, we identified that a number of exit packages were missing from the disclosure note as a result of report used not picking up all relevant termination benefits.	We recommend that appropriate procedure is in place to capture all relevant disclosure information from the payroll system and introduce some additional independent checks to ensure accuracy and completeness of this information.	Agreed, procedures will be reviewed and appropriate checks put in place.	Stuart Bull, Payroll Manager	Complete by 31 March 2018

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
ANNUAL REPORT AND ACCOUNTS					
Related party transactions (PRIOR YEAR RECOMMENDATION)	We recommended in the prior year that management review the methodology for disclosing related party relationships and transactions to ensure that the transactions disclosed are compliant with the Code and fully meet the definition of a related party per IAS 24. During the current year we identified a number of related party transactions disclosed in the financial statements did not meet the definition of related party transactions.	Review the methodology for disclosing related party transactions to ensure that the transactions disclosed are compliant with the Code and fully meet the definition of a related party per IAS 24. **RECOMMENDATION CARRIED FORWARD**	Agreed.	Jonathan Lloyd, Principal Technical Accountant	Complete by 31 March 2018
School balances (PRIOR YEAR RECOMMENDATION)	In the prior year we recommended that a process is put in place to identify any academy cash balances prior to the accounts close down. Our review of cash and bank balances in 2016/17 identified a number of the cash balances were in the name of schools which had converted to academy status prior to 31 March 2017. Therefore these balances do not actually belong to the Council.	We recommend that a process is put in place to identify any academy cash balances prior to the accounts close down. **RECOMMENDATION CARRIED FORWARD**	There is a four month academy cash reconciliation process in place. Medway try to ensure a speedy cash reconciliation for schools which convert on or after 1 December, but are not always successful. Not all of the schools cash balances are due to the new academy, some remain with Medway Council.	Maria Beaney, Finance Business Partner	Complete by 31 March 2018

APPENDIX III: MATERIALITY

MATERIALITY – FINAL AND PLANNING		
	FINAL	PLANNING
Materiality	£11,600,000	£11,700,000
Clearly trivial threshold	£350,000	£350,000

Planning materiality was based on 2% of average gross expenditure for the current and two preceding years. We revised our materiality downwards upon receipt of the draft financial statements, due to decrease in expenditure this year.

APPENDIX IV: INDEPENDENCE

We confirm that the firm complies with the Financial Reporting Council's Ethical Standards for Auditors and, in our professional judgement, is independent and objective within the meaning of those Standards.

In our professional judgement the policies and safeguards in place ensure that we are independent within the meaning of all regulatory and professional requirements and that the objectivity of the audit engagement lead and audit staff is not impaired. These policies include engagement lead and manager rotation, for which rotation is required after 5 years and 10 years respectively.

INDEPENDENCE - ENGAGEMENT TEAM ROTATION	
Senior team members	Number of years involved
David Eagles - Audit engagement lead	3
Matthew Hepenstal - Audit manager	1

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

INDEPENDENCE - THREATS TO INDEPENDENCE AND APPROPRIATE SAFEGUARDS
We have provided services other than audit to the Council as set out in Appendix V.

Other than the items identified in Appendix V, we have not identified any potential threats to our independence as auditors.
Should you have any comments or queries regarding this confirmation we would welcome their discussion in more detail.

APPENDIX V: FEES SCHEDULE

	2016/17 FINAL PROPOSED £	2016/17 PLANNED £	2015/16 FINAL £	EXPLANATION FOR VARIANCES
Code audit fee	142,451	142,451	142,451	n/a
Housing benefits subsidy claim	9,188	9,188	9,856	As per PSAA scale fee
TOTAL AUDIT AND CERTIFICATION FEES	**151,639**	**151,639**	**152,307**	
Reporting on government grants:				
• Pooling of Housing Capital Receipts return	3,200	3,200	3,200	n/a
• Teachers' Pension return	4,200	4,200	4,200	n/a
NON-AUDIT ASSURANCE SERVICES	**7,400**	**7,400**	**7,400**	
TOTAL ASSURANCE SERVICES	**159,039**	**159,039**	**159,707**	

APPENDIX VI: DRAFT REPRESENTATION LETTER

TO BE TYPED ON CLIENT HEADED NOTEPAPER

BDO LLP
16 The Havens
Ransomes Europark
Ipswich
Suffolk
IP3 9SJ

XX September 2017

Dear Sirs

Financial statements of Medway Council for the year ended 31 March 2017

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 2017 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 2015 and Statement of responsibilities of auditors and of audited bodies: local government issued by Public Sector Audit Appointments (PSAA), and in particular that the financial statements give a true and fair view of the financial position of the Council as of 31 March 2017 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 2015, 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.

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.

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.

APPENDIX VI: DRAFT REPRESENTATION LETTER

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 international financial reporting standards and preventing and detecting fraud and error.

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.

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.

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.

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.

We confirm the following significant assumptions made in relation to accounting estimates (including fair value measurements) used in the preparation of the financial statements are reasonable:

a) Pension fund assumptions

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

- Rate of inflation (CPI): 2.7%
- Rate of increase in salaries: 4.2%
- Rate of increase in pensions: 2.7%
- Rate of discounting scheme liabilities: 2.8%
- LGPS commutation take up option: 50%

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

APPENDIX VI: DRAFT REPRESENTATION LETTER

b) Valuation of housing stock, other land and buildings and investment properties

We are satisfied that the useful economic lives of the housing stock and other land and buildings, and their constituent components, used in the valuation of the housing stock and other land and buildings, and the calculation of the depreciation charge for the year, are reasonable.

We confirm that the valuations applied to council dwellings and other land and buildings revalued in the year, as provided by the valuer and accounted for in the financial statements, are reasonable and consistent with our knowledge of the business and current market prices.

We are satisfied that investment properties have been appropriately assessed as level 2 on the fair value hierarchy for valuation purposes and valued at fair value, based on highest and best use.

c) Allowance for non-collection of receivables

We are satisfied that the impairment allowances for council tax arrears, NDR arrears and housing benefit overpayments are reasonable, based on collection rate data.

We consider that the Council is able to continue to operate as a going concern and that it is appropriate to prepare the financial statements on a going concern basis.

We have disclosed all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements and these have been disclosed in accordance with the requirements of accounting standards.

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.

We acknowledge our legal responsibilities regarding disclosure of information to you as auditors and 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. Each director and member has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that you are aware of that information.

Yours faithfully

Phil Watts

Chief Finance Officer

[Date]

Barry Kemp

Chairman of the Audit Committee

Signed on behalf of the Audit Committee

[Date]

FOR MORE INFORMATION:

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