Appendix 1

MEDWAY COUNCIL

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2017

30 October 2017

BDO

EXECUTIVE SUMMARY

PURPOSE OF THE LETTER

This Annual Audit Letter summarises the key issues arising from the work that we have carried out in respect of the year ended 31 March 2017. It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public. It will be published on the website of Public Sector Audit Appointments Limited.

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 National Audit Office's (NAO's) Code of Audit Practice (the Code), and 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 report where we have exercised our statutory powers under the Local Audit and Accountability Act 2014 in any matter.

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
30 October 2017

AUDIT CONCLUSIONS

FINANCIAL STATEMENTS

We issued our unmodified true and fair opinion on the financial statements on 29 September 2017.

We reported our detailed findings to the Audit Committee on 28 September 2017 including the uncorrected misstatements which management and the Audit Committee concluded were immaterial.

USE OF RESOURCES

We issued our unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 29 September 2017.

EXERCISE OF STATUTORY POWERS

We received an objection to the 2015/16 accounts in respect of the borrowing incurred by the Council in the form of Lender Option Borrower Option (LOBO) loans, which still remains open.

This work remains on going although we were satisfied that these matters do not have a material effect on the financial statements or on our value for money conclusion.

FINANCIAL STATEMENTS

OPINION	We issued our unmodified true and fair opinion on the financial statements on 29 September 2017.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes an assessment of whether the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates, and the overall presentation of the financial statements.

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

Our audit was scoped by obtaining an understanding of the Council and its environment, including the system of internal control, and assessing the risks of material misstatement in the financial statements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
Management override of controls: Auditing standards presume that a risk of management override of controls is present in all entities. By its nature, there are no controls in place to mitigate the risk of management override.	We responded to this risk by: • 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.	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. No unusual or transactions outside of the normal course of business were identified.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
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.	We responded to this risk by testing a sample of fees and charges to ensure income was 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 a non-material error where income that should have been recognised in 2015/16 was recognised in 2016/17. The extrapolated error amounted to £0.47 million and was brought to the attention of management and the Audit Committee in our ISA 260 report. No other issues have been identified by our testing of revenue from fees and charges.
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. 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.	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 was appropriate based on their usage, and whether an instant build modern equivalent asset basis had 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. We noted that the internal valuer has not applied the correct adjustment factor when arriving at Existing Use Value - Social Housing (EUV-SH) for council dwelling which resulted in an understatement of the value of council dwellings by approximately £4.8 million. Management has amended the financial statements for this error.	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 are satisfied that the valuation bases used for different types of assets are appropriate, and assumptions used by the valuer are reasonable. 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.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
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. We considered there is a risk that valuation is not based on accurate membership data or uses inappropriate assumptions to value the liability.	We requested assurance from the auditor of the pension fund over the controls for providing accurate membership data 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 did not identify any issues regarding the accuracy and completeness of data provided by the Fund to the actuary. The PwC review has noted that the assumptions in respect of discount rate and inflation rate were above the expected range for these assumptions. We commissioned a separate review from an independent actuary (Broadstones) to review the strength of the assumptions. Based on this work, we are satisfied that the impact of the higher discount rate and inflation rates tend to counteract each other and the overall liability calculation is reasonable. We are satisfied that other assumptions used by the actuary are reasonable.
Changes in presentation of financial statements: The 2016/17 Code requires a change to the presentation of some areas of the financial statements and required 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 Movement in Reserves Statement (MiRS) is appropriate. Expenditure and Funding Analysis, Segmental Reporting and Expenditure and Income Analysis have been properly prepared in line with requirements of the Code.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
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. 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.	We agreed the underlying appeals information to the VOA reports of outstanding appeals. We reviewed the estimates provided by external expert and assessed the significant assumptions and methods used. We used VOA data to calculate the success rate from settled cases and compared this against the estimates provided by external expert.	Based on our audit work, we have concluded that the NDR appeals provision has been understated by £3.152 million in the Collection Fund, of which the Council's share of 49% equates to £1.544 million. This amount was below our materiality level and has been included as an unadjusted audit difference within our Audit Completion Report to the Audit Committee.

FINANCIAL STATEMENTS

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit and in evaluating the effect of misstatements.

We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonably knowledgeable users that are taken on the basis of the financial statements.

Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

The materiality for the financial statements as a whole was set at £11.6 million. This was determined with reference to a benchmark of gross expenditure (of which it equates to less than two per cent) which we consider to be one of the principal considerations for the Council in assessing the financial performance.

We agreed with the Audit Committee that we would report all individual audit differences in excess of £350,000.

AUDIT DIFFERENCES

A prior period adjustment was made to derecognise two properties which had been capitalised within property, plant and equipment with a value of £50.9 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).

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. The financial statements were amended for these errors.

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 £4.8 million. The misstatements identified have no impact on the General Fund or HRA balances at 31 March 2017.

In addition we identified four audit differences that were not corrected in the final financial statements as follows:

- The estimate for non-domestic rate appeals provision was understated by £1.5 million
- Cash balances of £0.5 million relating to schools that had converted to academy status not being removed from the Council's balance sheet
- Fees and charges of £0.5 million (extrapolated error) being recognised in 2016/17 which should have been recognised in 2015/16.
- Section 106 developer contributions of £4.5 million had been recognised in capital grants receipts in advance when this amount should have been recognised in the CIES as there were no outstanding conditions at the balance sheet date.

If corrected, these would increase net assets by £2.7 million and decrease the deficit on the provision of services by £2.2 million.

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

FINANCIAL STATEMENTS

OTHER MATTERS WE REPORT ON

Narrative report

The information given in the narrative report in the Statement of Accounts for the financial year was consistent with the financial statements.

Annual governance statement

The annual governance statement meets the disclosure requirements set out in the guidance ‘Delivering Good Governance in Local Government: Framework’ (2016 edition) published by CIPFA/SOLACE and was not misleading or inconsistent with other information that is forthcoming from the audit.

INTERNAL CONTROLS

We did not find any significant deficiencies in internal controls during the course of our audit. A number of other areas for improvement were identified which we have discussed with management.

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 certain non-current assets); liabilities (excluding pension liabilities); income or expenditure.

Our work in connection with the WGA is currently in progress and we anticipate completing this work in the near future.

We are required to perform our review in accordance with the Group Audit Instructions issued by the National Audit Office. This requires that we compare the information in your Data Collection Tool (DCT) submission with the audited financial statements, undertake testing of completeness and accuracy of WGA counter party transactions and balances, and provide an assurance statement to the National Audit Office.

USE OF RESOURCES

CONCLUSION	We issued our unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 29 September 2017.

SCOPE OF THE AUDIT OF 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 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.

As part of reaching our overall conclusion we consider the following sub criteria in our work: informed decision making, sustainable resource deployment, and working with partners and other third parties.

OUR ASSESSMENT OF SIGNIFICANT RISKS

Our audit was scoped by our cumulative knowledge brought forward from previous audits, relevant findings from work undertaken in support of the opinion on financial statements, reports from the Council including internal audit, information disclosed or available to support the governance statement and annual report, and information available from the risk registers and supporting arrangements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and direction of the efforts of the audit team.

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
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. 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 and a number of other measures including outsourcing and reduction in expenditure.	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 and considered reasonableness and viability of these saving plans alongside their up to date progress. 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. 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. Much of the savings from digital transformation is expected over the coming years, and the Council is progressing towards achieving budgeted savings for 2017/18. 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.	Whilst 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. 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. Sufficient reserves and balances are available to support the Council's services in the medium term, should there be under performance against savings plans.

EXERCISE OF STATUTORY POWERS

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

OBJECTIONS

We received an objection to the 2015/16 accounts in respect of the borrowing incurred by the Council in the form of Lender Option Borrower Option (LOBO) loans, which still remains open.

Legal advice obtained suggests that, whilst LOBOs are not inherently illegal, their legality is dependent upon the nature and basis of the decision to take out the loans.

This work remains on going although we were satisfied that these matters do not have a material effect on the financial statements or on our value for money conclusion.

We will formally respond to the objectors upon completion of our work.

AUDIT CERTIFICATE

We are unable to issue the audit certificate to close the audit until we have completed our investigations and responded to objector for the matters raised.

APPENDIX

REPORTS ISSUED

We issued the following reports since our previous annual audit letter.

REPORT	DATE
Audit plan	March 2017
Grant claims and certification work 2015/16	March 2017
Audit completion report	September 2017
Annual audit letter	October 2017

FEES

We reported our original fee proposals in our audit.

We have not had to amend our planned fees.

AUDIT AREA	FINAL FEES £	PLANNED FEES £
Council audit - scale fees	142,451	142,451
Housing benefits subsidy claim	9,188	9,188
Total audit and certification fees	**151,639**	**151,639**
Fees for non-audit services:		
Housing Capital Receipts return	3,200	3,200
Teachers' Pension Return	4,200	4,200
Total non-audit assurance fees	**7,400**	**7,400**
Total Fees	**159,039**	**159,039**

FOR MORE INFORMATION:

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