Appendix 1

MEDWAY COUNCIL

AUDIT COMPLETION REPORT

Audit for the year ended 31 March 2018

19 July 2018

BDO

CONTENTS

WELCOME

We have pleasure in presenting our Audit Completion Report to the Audit Committee. This report is an integral part of our communication strategy with you, a strategy which is designed to ensure effective two way communication throughout the audit process with those charged with governance.

It summarises the results of completing the planned audit approach for the year ended 31 March 2018, specific audit findings and areas requiring further discussion and/or the attention of the Audit Committee. At the completion stage of the audit it is essential that we engage with the Audit Committee on the results of audit work on key risk areas, including significant estimates and judgements made by management, critical accounting policies, any significant deficiencies in internal controls, and the presentation and disclosure in the financial statements.

We look forward to discussing these matters with you at the Audit Committee meeting on 30 July 2018, and to receiving your input.

In the meantime if you would like to discuss any aspects in advance of the meeting we would be happy to do so.

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. This report has been prepared solely for the use of the Audit Committee and those charged with governance. In preparing this report we do not accept or assume responsibility for any other purpose or to any other person. For more information on our respective responsibilities please see the Appendices.

We would also like to take this opportunity to thank the management and staff of the Council for the co-operation and assistance provided during the audit.

OVERVIEW

This summary provides an overview of the audit matters that we believe are important to the Audit Committee in reviewing the results of the audit of the financial statements and use of resources of the Council for the year ended 31 March 2018.

It is also intended to promote effective communication and discussion and to ensure that the results of the audit appropriately incorporate input from those charged with governance.

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 update	No additional significant audit risks were identified during the course of our audit procedures subsequent to our Audit Plan to you dated 1 March 2018.
Materiality	Our final materiality is £10,600,000. Our materiality levels have not required reassessment since our audit planning referred to above. However, these have been updated to reflect actual gross expenditure reported in the draft financial statements presented for audit.
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	Our audit identified the following material disclosure misstatements: • On the face of the Cash Flow Statement and in the related notes, cash flows from operating activities had been understated by £17.118 million with a corresponding overstatement of cash flows from investing activities. This is due to capital grants and contributions being incorrectly treated in the Cash Flow Statement and related notes, as set out on page 14. Management has amended the financial statements for this issue. • Carrying value and fair value of borrowings in the financial liabilities disclosure note were incorrectly understated by £68.941 million and £106.202 million respectively, as set out on page 15. Management has amended the financial statements for this issue. • The exit packages disclosure note was not prepared in line with the Code requirements. The disclosure was prepared on the basis of exit packages that had been ‘paid’ during the year, as opposed to the Code requirement of exit packages that had been ‘agreed’ during the year. This also resulted in a restatement to the prior period disclosure note. The disclosure is considered to be material by nature due to the sensitive nature of this information. The details of these amendments are set out on page 14. At the date of this report the disclosure note is in the process of being updated by management.

OVERVIEW

KEY AUDIT AND ACCOUNTING MATTERS CONTINUED	
Unadjusted audit differences	We are required to bring to your attention audit differences that we have identified, but you are not proposing to adjust. These include: • Recognition of expenditure totalling £2.546 million of additions to property, plant and equipment when such expenditure should have been recognised as revenue expenditure funded from capital under statute (REFCUS). • Recognition of section 106 developer contributions of £3.690 million received during the year in capital grants receipts in advance (liability) when it is more appropriate to recognise such contributions in the Comprehensive Income and Expenditure Statement (CIES) as income. The contributions received in prior periods totalling £2.457 million had been utilised during the year and recognised in the CIES. These would have been recognised in the CIES in the respective prior period when such contributions were received. • Brought forward misstatement in respect of the understatement of non-domestic rates appeals provision in the prior year by £1.544 million. If corrected, these audit differences would decrease the deficit on the provision of services for the year by £2.452 million.
Control environment	Our audit identified the following significant deficiencies in internal controls: • Valuation of property, plant and equipment (PPE) by the internal valuers was not subject to a detailed review and sense check within the valuation team which resulted in a number of errors in the valuation calculations. Given the associated significant risk in relation to the valuation of PPE, this warrants classification as a significant control deficiency. • In the prior year we included a recommendation to management that appropriate procedures should be put in place to capture all relevant disclosure information relating to exit packages. As set out on page 14 we identified some further issues during the current year audit. The exit packages disclosure is considered to be material by nature due to the sensitive nature of this information, consequently this warrants classification as a significant control deficiency.
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. The Council's usable reserves have been reduced by a third over the past two years, and available sources for identifying further savings over the coming years are limited. Whilst the Council has identified a significant funding gap, actions are 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.

OVERVIEW

AUDIT OPINION	
Financial statements	Subject to the successful resolution of outstanding matters set out on page 6, we anticipate issuing an unmodified opinion on the financial statements for the year ended 31 March 2018.
Other information	We propose issuing an unmodified opinion on the consistency of the other information in the Statement of Accounts with the financial statements and our knowledge.
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 6, we anticipate issuing an unmodified opinion on the arrangements in place to secure economy, efficiency and effectiveness in the use of resources for the year ended 31 March 2018.
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 plan to issue our opinion on the consistency of the DCT return with the audited financial statements before the 31 August 2018 statutory deadline.
Audit independence	Our observations on our audit independence and objectivity and related matters are set out in Appendix IV.
Management letter of representation	The draft management letter of representation, to be approved and signed, is set out in Appendix VI.
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). We have substantially completed our work in respect of the objection received and we anticipate responding to this in due course.

OUTSTANDING MATTERS

We have substantially completed our audit work for the year ended 31 March 2018, and anticipate issuing an unmodified opinion on the financial statements.

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	Clearance of outstanding issues on the audit queries tracker currently with management. This includes receiving an updated working paper to support revised exit packages disclosure note and our audit procedures thereon.
2	Receipt of the following confirmation letters: - Lloyds Bank deposit account number CLTK/1933 - Barclays Bank account number 80717517 - LOBO loan confirmation letter from Bayerische Landesbank Girozentrale
3	Completion of the audit testing in respect of journals entries and reserves
4	Completion of partner, manager and quality control review of the audit file and clearance of review points
5	Assessment of extent of valuer's work on reviewing any fair value differences for PPE as at 31 March 2018 to most recent valuations undertaken across the 5 years rolling valuation programme (i.e. compared to 2013/14 to 2016/17 valuations)
6	Final review and approval by you of the Statement of Accounts
7	Technical clearance
8	Subsequent events review
9	Management letter of representation, as attached in Appendix VI to be approved and signed

KEY AUDIT AND ACCOUNTING MATTERS

AUDIT RISKS

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.	We have: • Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements • Reviewed accounting estimates for bias and evaluated whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud • Obtained 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 we have assessed may be indicative of a higher level of management override risk. We have then carried out testing in order to verify the appropriateness of these journals. Our audit work in relation to journals is ongoing, and to date we have not identified any significant issues. We will provide a verbal update to the Audit Committee on the outcome of this work. We have not found any indication of material management bias in accounting estimates. 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 during our audit work.

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. In particular, we consider there to be a significant risk in relation to the accuracy and existence (recognition) of fees and charges recorded in the Comprehensive Income and Expenditure Statement (CIES) with a particular focus on year-end cut off as this could be 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 an extended sample of fees and charges to ensure income had been recorded in the correct period and that all income recognised is valid.	Our testing on fees and charges income did not identify income recognised in an incorrect financial year, or income recognised in the year that was accurate or did not exist.

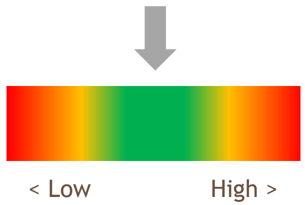
KEY AUDIT AND ACCOUNTING MATTERS

	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 values of land, buildings, dwellings and investment properties are 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 a revaluation programme which is determined through consultation between the finance team and the valuation team. Council dwellings and investment properties are revalued on an annual basis. For other land and buildings, those properties 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 remainder of the assets revalued periodically (minimum of every five years). During the year the asset valuations were undertaken by internal valuers. We consider there to be a risk over the valuation of land, buildings, dwellings and investment properties due to inherent uncertainty and judgement involved in valuation of these assets, and valuations are based on market assumptions.	• We reviewed the instructions provided to the internal valuers and reviewed their skills and expertise in order to determine whether we could rely on the management expert. • We assessed whether the basis of valuation for assets valued in the 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 (DRC). • For a sample of council dwellings and other land and buildings valued under existing use value (EUV) basis we obtained comparable sales data to assess reasonableness of valuations. • For a sample of other land and buildings valued under DRC basis we agreed gross internal areas and site areas used in the valuations to Council's internal data, build cost used was agreed to BCIS published information and obsolescence percentage applied was reviewed for reasonableness. • For a sample of investment properties we calculated rental yield and compared this to average yield on similar properties. • 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 valuer for accuracy and reasonableness, including the reasonableness of the carrying value of assets not revalued during the year.	We were satisfied that we could rely on the valuer's work. We are satisfied that the basis of the valuation for each asset is appropriate and that the revaluation movements have been correctly accounted for. Our sample testing of council dwellings, other land and buildings valued under EUV basis and investment properties has not identified any issues. Our testing of the assets valued under the DRC method identified 5 issues. These were due to application of incorrect build cost, not applying a suitable location factor to adjust the national build cost as relevant to Kent, a formula error in the calculation sheet, a transposition error from the valuation sheet to the final valuation report and not removing the building valuation for a property demolished from the final valuation report. These issues resulted in an understatement of valuation of 3 properties by £4.773 million and overstatement of valuation of 2 properties by £1.555 million, with a net understatement of £3.218 million and a corresponding understatement of the revaluation reserve. Management has amended the financial statements for these issues. We have included a recommendation to management in respect of these issues in Appendix II. We are satisfied that the valuations provided for council dwellings and other land and buildings revalued during the year are in line with relevant market indices. We have ongoing work considering unindexed valuations from earlier years in the 5 years rolling revaluation programme. We will provide a verbal update to the Audit Committee on the outcome of this matter. 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	IMPACT
Council dwellings are valued by reference to open market value less a social housing discount Land and buildings are valued by reference to existing use market values Some specialist buildings are valued at depreciated replacement cost by reference to building indices Investment properties are valued by reference to highest and best use market value	**Council dwellings** For council dwellings, the internal valuer has applied a flat rate increase ranging from 3.4% to 5.4% depending on the property type, which is based on the valuer's market research. Where direct comparable sales have been identified for certain property beacons these have been applied instead of applying the above fixed rate increase. These resulted in an overall net revaluation gain of £6.726 million, which represents an average increase of 4.3%. We have compared this to the house price increase for South Eastern region given in the Gerald Eve report, who acts as auditor's expert in respect of valuation of properties, which showed an increase of 3.3% over the same period. However, Land Registry data for Medway local authority area showed an increase in house prices over the period of 4.5%, which is considered to be more accurate and reflects local data. Had the value of council dwellings been increased by 4.5%, as opposed to the average increase of 4.3% above, this would have increased the overall valuation by £0.390 million which is not material. Therefore, we are satisfied that valuation of council dwellings at 31 March 2018 is materially correct. **Other land and buildings (including specialist buildings)** The overall value of other land and buildings has increased by £21.606 million, which represents an average increase of 6.7%. BCIS All-in TPI index is considered to be a guiding index for specialised properties which has increased by 6.7% during the year. For non-specialised properties MSCI capital value index is considered to be appropriate, which has increased by 5%. Approximately 40% of Council's other land and buildings are specialised properties, as such the weighted average increase of above indices is 5.7%. Had the value of other land and buildings been increased by 5.7%, this would have resulted in an increase in valuation of £18.169 million, which represents a variance of £3.437 million from the actual increase in valuation during the year. This is within a reasonable range and therefore we are satisfied that the valuation provided for other land and buildings revalued during the year are reasonable. As set out on page 6, we are yet to receive a management assessment of the assets not revalued during the year to ensure that their carrying values are not materially different from their current values. We will provide a verbal update to the Audit Committee on the outcome of this matter. **Investment properties** Investment properties have seen an overall decrease in valuation of £1.201 million (12.5%), of which £1.322 million was attributable to Gillingham Business Park. Discussions with the valuer revealed that the decrease in valuation was due to increased level of irrecoverable costs such as rates, lost service charges and insurance for void units etc. We reviewed the 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 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 Barnett Waddingham, 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 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 a 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 agreed the disclosures to the information provided by the pension fund actuary.	We did not identify any issues regarding the accuracy of the disclosures in the financial statements or the accuracy and completeness of data provided by the fund to the actuary. There have been 14 schools converted to academy status during the year and information relating to these transfers have been communicated to the actuary. We confirmed to the actuary's report that these transfers have been taken into account and membership data has been updated to reflect these changes. We confirmed that there have been no other 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 on the following page.

KEY AUDIT AND ACCOUNTING MATTERS

SIGNIFICANT ACCOUNTING ESTIMATES

Pension liability assumptions

ESTIMATE

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

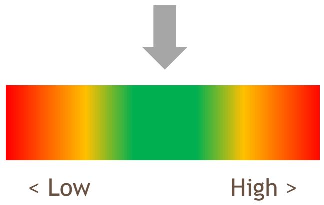
HOW RISK WAS ADDRESSED BY OUR AUDIT

The gross pension liability of the Council has decreased by £2.935 million, from £792.705 million to £789.770 million. This is principally due to a reduction in the CPI inflation rate used to value future liabilities (from 2.7% to 2.3%) which was partially offset by a decrease in discount rate (from 2.8% to 2.55%). 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	3.3%	3.3-3.35%	Reasonable
CPI increase	2.3%	2.3-2.35%	Reasonable
Salary increase	3.8%	--	Employer specific (this is long term salary increase and reasonable in context of RPI and CPI)
Pension increase	2.3%	2.3-2.35%	Reasonable
Discount rate	2.55%	2.5-2.6%	Reasonable
Mortality - LGPS:			
- Male current	25.3 years	23.7-26.8	Reasonable
- Female current	27.5 years	26.6-28.4	Reasonable
- Male retired	23.1 years	21.5-24.5	Reasonable
- Female retired	25.2 years	24.3-26.1	Reasonable
Commutation	50%	50%	Reasonable

All the assumptions used fall within the reasonable range for the actuary as per the PwC report. Therefore, we are satisfied that financial and actuarial assumptions used by the actuary are reasonable and would result in a materially correct valuation of gross pension liability at the balance sheet date.

IMPACT



KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
5	Consideration of related party transactions	Whilst the Council is responsible for the completeness of the disclosure of related party transactions in the financial statements, we are also required to consider related party transactions in the context of fraud as they may present greater risk for management override or concealment or fraud. 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.	Our testing identified the following issues: • The Finance Department has not been provided with up to date information on member's declaration of interests which is held by the Democratic Services Department. As a result there were a number of entities identified where members had an interest, but were not subject to a search within the Integra finance system to identify any transactions during the year by the Finance Team. Our testing identified that the Council has made payments totalling £30.5k during the year to a charitable company where a member of the Council was a director, of which the Finance Department was not aware although the interest had been declared to Democratic Services. We have included a recommendation to management in respect of this matter in Appendix II. • Whilst disclosures had been made to provide the related party relationship between the Council and its non-consolidated subsidiary company, Medway Commercial Group Ltd and its two subsidiary companies, no disclosures had been made for transactions during the year and balances at the year end with these companies. • We also identified a few other minor amendments to the disclosure information presented. Management has amended the financial statements for the above 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
1	Cash flow statement and related notes	The Code requires any cash flows which are included within the surplus or deficit on provision of services, but their cash effects are investing or financing cash flows, should be reclassified to investing or financing cash flows as appropriate. In line with this requirement capital grants and contributions of £17.118 million recognised in the CIES should be reclassified within investing cash flows. This 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 not made, which resulted in operating cash flows being understated by £17.118 million with a corresponding overstatement of investing cash flows. We also identified the following non-cash items adjusted against the deficit for the year were incorrectly stated: - Depreciation was stated as £29.907 million as opposed to the correct amount of £33.767 million - Impairment and downward revaluations was stated as £2.180 million as opposed to the correct amount of £7.240 million - Increase in creditors was stated as (£2.560) million as opposed to the correct amount of (£4.780) million - Increase in debtors was stated as £14.546 million as opposed to the correct amount of £16.765 million - Other non-cash items charged to the net deficit on provision of services was stated at £31k as opposed to the correct amount of (£1.170) million. Management has amended the financial statements for the above issues.
2	Disclosure of exit packages	The Code requires that number and total cost of exit packages agreed during the year should be disclosed and these should be grouped in rising bands of £20,000 up to £100,000, and bands of £50,000 thereafter. We identified through our testing that the disclosure note had been prepared on the basis of exit packages being 'paid' during the year as opposed to the Code requirement of exit packages being 'agreed' during the year. Our testing identified that one exit package disclosed within the £100,001 - £150,000 band and two exit packages disclosed within the £0 - £20,000 band were agreed in 2016/17 but paid in 2017/18. In line with the Code requirements these packages should have been disclosed in the prior year. Due to the sensitive nature of this information the disclosure is considered to be material by nature, hence a prior period adjustment would be required to restate the comparative disclosure for 2016/17. We requested management to update the disclosure note in line with the Code requirements, and a revised working paper was sought. Management agreed to amend the financial statements for the above issues, and at the date of this report this is in the process of being updated. We have included a recommendation to management in respect of this matter within Appendix II.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	AUDIT FINDINGS
3	Financial instrument disclosures	We identified a number of disclosure issues within the financial instruments disclosure notes. These were as follows: • Carrying value of borrowings disclosed within the financial liabilities fair value table did not include short term borrowings which resulted in an understatement of the carrying value of borrowings by £68.941 million. • Fair value of borrowings disclosed within the financial liabilities fair value table was incorrectly stated as £246.405 million when the correct amount is £352.607 million. Therefore, fair value of borrowings was understated by £106.202 million. • Financial assets classified as loans and receivables had been overstated by £5.729 million as this included housing benefit debtors which arise from statute, hence do not form part of financial instruments. This also resulted in an overstatement of fair value of loans and receivables by the same amount. • Within the disclosure of income, expenses, gains and losses for financial instruments, no income has been included against available for sale financial assets. Dividend income of £645k has been received during the year for these assets which was included against loans and receivables financial assets. • Within the maturity analysis of financial liabilities the amounts due within one year and between one and two years were incorrectly stated (total gross liabilities were overstated by £1.903 million). • We also identified a number of other minor amendments to various disclosures within this note. Management has amended the financial statements for these issues.
4	Presentation of Collection Fund Statement and non-domestic rates (NDR) appeals provision	Within the draft provision note and non-domestic rates appeals provision note within notes to the Collection Fund Statement, no amounts had been disclosed for provisions utilised during the year. Our audit procedures revealed that the Council has settled £9.742 million during the year for successful NDR appeals, and this amount had been net-off against NDR income in the Collection Fund Statement. This resulted in an understatement of NDR income with a corresponding understatement of NDR provision for appeals in the Collection Fund Statement. 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 from rate payers 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 was not disclosed in the draft provision notes. We have included a recommendation on Appendix II in respect of this matter. Management has amended the financial statements for the above issues.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	AUDIT FINDINGS
5	Capital Grants Receipts in Advance (Section 106 Contributions)	Within the draft financial statements the Council has recognised Capital Grants Receipts in Advance of £5.711m in respect of Section 106 (s.106) developer contributions. Developers are asked to provide contributions for infrastructure where a 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 (which has been reduced to 5 years in 2017/18) 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 10/5 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 in accordance with 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 10/5 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 Council has received s.106 contributions of £3.690 million during the year and these amounts have been recognised in liabilities. We consider these should have been recognised in the CIES. The contributions received in prior years totalling £2.457 million have been utilised in 2017/18 and recognised in the CIES, which would have been recognised in the CIES in respective prior periods. The Financial statements will not be amended for the above issues. Whilst we recognise the subjective nature of the 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.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	AUDIT FINDINGS
6	Property, plant and equipment (PPE) additions	During our review of PPE additions we noted the following expenditure which had been capitalised within PPE should have been recognised as revenue expenditure funded from capital under statute (REFCUS). • Expenditure totalling £2.258 million had been incurred in respect of a capital project undertaken for expanding a school property. The school was converted to an academy status during the financial year which was known by the Council at the beginning of the year. As the property expansion was carried out with a view of subsequent transfer to the academy, there was no associated future economic benefit to the Council, which is a requirement for recognition of PPE. The amount has been initially recognised in PPE additions and subsequently recognised in disposals when the asset was transferred to the academy at nil proceed. • The Council has part funded a reconstruction of a railway station which was not owned by the Council. During the financial year, the Council has funded £288k towards this project and this amount had been recognised in additions to PPE. A further £37k retention has been omitted from the ledger. The accounting policy in respect of REFCUS states that expenditure incurred during the year that may be capitalised under statutory provisions but does not result in the creation of recognisable non-current assets would be charged as expenditure to the relevant directorate in the CIES in the year. In line with this policy, the above expenditures should have been recognised in REFCUS. The financial statements will not be amended for these issues and we have included an uncorrected misstatement within the Appendix I.
7	Other disclosure issues	We identified a number of other disclosure issues within the draft financial statements as follows: • A number of amendments were identified to the disclosure note in respect of dedicated school grants. These included missing information, casting errors, incorrect reference to relevant Regulation and certain disclosures which were not in line with the Code guidance. • The disclosure of vacant possession value of dwellings within the authority's HRA as at 1 April 2017 was incorrectly disclosed as being £462.4 million as opposed to the correct value of £476.7 million. • Remuneration disclosed for Assistant Director - Physical and Cultural Regeneration was understated by £3,725. Management has amended the financial statements for the above issues.

KEY AUDIT AND ACCOUNTING MATTERS

MATTERS REQUIRING ADDITIONAL CONSIDERATION
We comment below on other matters requiring additional consideration:

	AUDIT AREA	AUDIT FINDINGS
1	Fraud	Whilst Management has ultimate responsibility for prevention and detection of fraud, we are required to obtain reasonable assurance that the financial statements are free from material misstatement, including those arising as a result of fraud. Our audit procedures did not identify any fraud. We will seek confirmation from those charged with governance on whether you are aware of any known, suspected or alleged frauds since we last enquired when presenting the Audit Plan on 20 March 2018.
2	Internal audit	We reviewed the reports issued and audit work of the Council's Internal Audit function to assist our risk scoping at the planning stage. Our review of the work of Internal Audit did not identify any additional risk.

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
1	We are required to report on whether the financial and non-financial information in the Narrative Report within the Statement of Accounts is consistent with the financial statements and the knowledge acquired by us in the course of our audit.	Our audit identified the following inconsistences between the other information in the Statement of Accounts and the financial statements: • Within the narrative reports a table has been included to present a comparison between budgeted income and expenditure against actual results for the year. Within this table actual council tax income for the year has been disclosed as being £106.148 million, which is different from the amount of £108.317 million recognised in the CIES and disclosed within Taxation and Non-specific Grant Income note. • Within the above table, actual non-domestic rates income has been disclosed as being £46.302 million, which is different from the amount of £45.723 million recognised in the CIES and disclosed within Taxation and Non-specific Grant Income note. Management explained that these differences are due a different basis of presentation adopted in the narrative reports than in the CIES. We have requested management to include additional disclosures within narrative reports to explain the different basis of presentation, and management has included these additional disclosures. We also identified a few other minor amendments to the narrative reports for which management has amended the narrative reports. With the above amendments, we are satisfied that the other information in the Statement of Accounts is consistent with the financial statements and our knowledge.
2	We are required to report by exception if the Annual Governance Statement does not meet the disclosure requirements set out in the guidance 'Delivering Good Governance in Local Government Framework' (2016 Edition) published by CIPFA/SOLACE or is misleading or inconsistent with other information that is forthcoming from the audit.	We have no matters to report in relation to the Annual Governance Statement's compliance with relevant guidance.

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 the Audit Committee.

As the purpose of the audit is for us to express an opinion on the Council's 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.

We note that the Council’s internal audit function has issued a number of observations and recommendations on the Council’s control environment during 2017/18. 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.

Our audit has identified the following significant deficiencies, which are included in the action plan at Appendix II:

- Valuation of property, plant and equipment (PPE) by internal valuers was not subject to detailed review and sense checking within the valuation team which resulted in a number of errors in the valuation calculations. Given the associated significant risk in relation to valuation of PPE, this warrants classification as a significant control deficiency.
- In the prior year we included a recommendation to Management that appropriate procedures are in place to capture all relevant disclosure information relating to exit packages. As set out on page 14 we identified some further issues during the current year audit. The exit packages disclosure is considered to be material by nature due to the sensitive nature of this information, consequently this warrants classification as a significant control deficiency

We have also identified other 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
1	For Whole of Government Accounts (WGA) component bodies that are over the prescribed threshold of £500 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 14 June 2018. The Council met this deadline. 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 will issue our opinion on the consistency of the DCT return with the audited financial statements before the 31 August 2018 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) and report to you on an 'except for' basis. 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 a use of resources significant risk in respect of sustainable resource deployment, in the 2017/18 Audit Plan issued on 1 March 2018. 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 identified any additional significant risks.

We have not identified any significant risks in relation to informed decision making or working with partners and other third parties.

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

Key: ■ Significant risk ■ Normal risk ■ Other issue

USE OF RESOURCES

RISK AREA		RISK DESCRIPTION AND WORK PERFORMED	AUDIT FINDINGS AND CONCLUSION
1	Sustainable finances (sustainable resource deployment)	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 Medium Term Financial Strategy (MTFS) was updated in September 2017 and forecasts a budget gap of £4.1 million in 2018/19, increasing to £17.7 million by 2021/22. Although, the Council has identified some savings plans in order to address this budget gap, the savings targets remain significant and achievement of these will be inherently challenging. We completed the following: • We reviewed the assumptions used in the Medium Term Financial Strategy and assessed the reasonableness of the cost pressures and the amount of Government grant reductions applied. • We monitored the delivery of the budgeted savings in 2017/18 and the plans to reduce services costs and increase income from 2018/19. • We reviewed the strategies to close the budget gap after 2018/19. **Financial performance 2017/18** The Council's revised budget requirements for 2017/18 were £294.5 million. The final outturn for the year was close to breakeven with a modest underspend of £58k. Children & Adults and Business Support budgets were underspent by £453k and £505k respectively, which was partially offset by the overspend on Regeneration, Culture, Environmental and Transformation (RCET) budget by £439k. Subsequent to the 2017/18 initial budget the Council has received an additional £4 million grant towards the Better Care Fund which had a favourable impact on the Children & Adults budget. The overall underspend on Children & Adults on the revised budget is largely due to the underspend on placements due to the use of foster placements, special guardianships and in-house residential placements, rather than external residential placements. The overspend on RCET is largely due to the under-achievement of stretch income targets in Leisure Services as a result of a changing leisure market, characterised by the rise of budget gyms. **2018/19 Budget and Medium Term Financial Plan assumptions** Subsequent to the updates to MTFS in September 2017, the Council has set a balanced budget for 2018/19. We reviewed the key assumptions underpinning 2018/19 budget. The budget assumes an increase in council tax by 5.994% representing Government's referendum limit together with social care precept, which the Council has approved.	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 2022. Whilst the Council has identified a significant funding gap, actions are being taken to ensure the matter is addressed and the Council has a track record of achieving its financial plans. Therefore, while there is a recognised funding gap in the MTFS, 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 MTFS. We have raised some recommendations in Appendix II to help the Council further strengthen the management of its financial position.

USE OF RESOURCES

RISK AREA		RISK DESCRIPTION AND WORK PERFORMED	AUDIT FINDINGS AND CONCLUSION
1	Sustainable finances (sustainable resource deployment)	The Council has been successful to pilot 100% business rates retention in 2018/19 which is expected to generate some additional savings, although the budget has been set such that this will have a fiscally neutral effect. Our review of the other funding assumptions such as education related grants, public health grants and adult social care grants confirmed that they are reasonable. The 2018/19 budget assumes a further £5 million savings from digital transformation, which is expected to be a recurring saving over the period of MTFS. This includes adult social care diagnostic re-phasing savings of £1,868k. The Council has engaged an external management consultancy firm to identify the savings available and they expect to achieve higher savings than originally planned by the Council. Our review of these and the other savings identified in the 2018/19 budget confirmed that they are reasonable. Our review of the MTFS assumptions identified that these adequately reflect demographic and inflationary cost pressures, pay awards and increases in national living wage and other known cost pressures. The assumptions around funding sources are reasonable and reflect published information and Government announcements. **Financial performance 2018/19** Provisional outturn for Q1 2018/19 indicates a forecast overspend, although management action plans are being formulated and management anticipate that this will be mitigated further as the year progresses. **Reserves and balances** At 31 March 2018 the Council had General Fund balance of £5 million, HRA balance of £4.9 million, Earmarked General Fund reserves of £14.2 million and Capital Grants Unapplied and Capital Receipts of £8.6 million, thus total usable reserves of £32.7 million. As set out on page 16, the Council has recognised s.106 contributions of £5.7 million as a liability which should have been recognised as capital grants unapplied. However, total usable reserves have significantly decreased over the past years. These have been halved over the past five years, and reduced by a third during the last two years. The 2018/19 revenue budget and MTFS only assumes a planned draw from revenue reserves of £50k. 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

Our audit has not identified any material misstatements. However, we have identified 3 material disclosure misstatements which are in respect of incorrect disclosures within the Statement of Cash Flows, financial instruments disclosures and exit packages disclosure.

There were 2 immaterial audit differences identified by our audit work that were adjusted by management:

- As set out on page 9, we identified a number of errors within the work of property, plant and equipment (PPE) valuation carried out by the internal valuers, which resulted in PPE assets being understated by £3.218 million with a corresponding understatement to the revaluation reserve.
- As set out on page 15, within the Collection Fund Statement non-domestic rates income and non-domestic rates appeals provision both being understated by £9.742 million.

These adjustments increased the deficit on provision of services by £0.848 million, from £58.880 million to £59.728 million.

UNADJUSTED AUDIT DIFFERENCES

There are 3 unadjusted audit differences identified by our audit work, and if corrected, these would decrease the deficit on the provision of services for the year by £2.452 million. 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		STATEMEMENT OF FINANCIAL POSITION	
		DR	CR	DR	CR
	£'000	£'000	£'000	£'000	£'000
Net operating expenditure for the year before adjustments	59,728				
DR CIES Expenses - Children and Adults (REFCUS)		2,258			
CR Other Operating Expenses (Loss on Disposal of Non-current Assets)			2,258		
1. (a) Being the net adjustment required to correctly account for expenditure capitalised in respect of Bligh Schools within REFCUS. The school was converted to an academy, as such expenditure should have been recognised in REFCUS.	-				
DR CIES Expenses - RCET (REFCUS)	325	325			
PPE Additions - Other Land and Buildings					288
Short Term Creditors					37
Capital Adjustment Account (CAA)				325	
General Fund					325
1. (b) Being recognition of expenditure incurred in respect of Strood Railway Station in REFCUS and subsequent transfer to CAA via MiRS. The Strood Railway Station is not owned by the Council, hence expenses should be reflected in REFCUS.					

APPENDIX I: AUDIT DIFFERENCES

		INCOME AND EXPENDITURE		STATEMEMENT OF FINANCIAL POSITION	
		DR	CR	DR	CR
	£'000	£'000	£'000	£'000	£'000
DR Grants Receipts in Advance - Capital				5,711	
CR Capital Grant Unapplied					5,711
CR Taxation and non-specific grant income (CIES)	(1,233)		1,233		
DR General Fund				1,233	
(2) Being the net adjustment required to recognise Section 106 contributions received in the CIES and subsequent transfer from General Fund to Capital Grants Unapplied via MiRS as required by the Code.					
DR General Fund B/F				1,544	
CR Taxation & Non-specific Grant Income (NDR Income)	(1,544)		1,544		
(3) B/F misstatement - Being potential understatement of NDR Provision in the prior year.					
TOTAL UNADJUSTED AUDIT DIFFERENCES	(2,452)	2,583	5,035	8,813	6,361
Deficit on provision of services if adjustments accounted for	57,276				

APPENDIX I: AUDIT DIFFERENCES

IMPACT ON GENERAL FUND AND HRA BALANCES	GENERAL FUND BALANCE £000s	HRA BALANCE £000s
Balances before adjustments	5,000	4,910
Adjustments to CIES above	2,452	
Adjustments via movement in Reserves Statement:		
DR General Fund/HRA	(908)	-
CR General Fund/HRA	-	-
BALANCES AFTER ADJUSTMENTS	6,544	4,910

UNADJUSTED DISCLOSURE MATTERS
There are no any unadjusted disclosure misstatements.

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
STATEMENT OF ACCOUNTS AND FINANCIAL STATEMENTS					
Valuation of property, plant & equipment (PPE) and investment properties	As set out on page 9, we have identified a number of issues within the valuation calculations performed by the Council's internal valuers and compilation of the final valuation report. These issues could have been avoided had the valuation calculations and the final valuation report been subject to second review. Valuation of PPE is considered to be an area of significant risk and similar errors could result in a materially incorrect valuation being recognised in the financial statements.	We recommend that all valuation calculations are subject to second review within the valuation team and valuation movements are reviewed for reasonableness alongside the movement in similar assets revalued. This review would include comparison of assumptions applied such as build cost, obsolescence percentage etc. for DRC valuation and land value per acre applied by different internal valuers.	Agreed. Review in progress.	Noel Filmer	Commenced
Disclosure of exit packages	In the prior year we included a recommendation that appropriate procedures are in place to capture all relevant disclosure information relating to exit packages from the payroll system and to introduce some additional independent checks to ensure accuracy and completeness of this information. As set out on page 14, we have identified some further issues during the current year audit. The disclosure note has been prepared on the basis of exit packages paid during the year as opposed to the packages agreed on during the year, which is not in line with Code requirements.	We recommend that a log of exit packages information is maintained by HR and/or payroll team which provides relevant disclosure information such as date agreed, date paid and amount etc. We also recommend that the financial accounts team provides necessary guidance on Code requirements to the payroll team and ensures exit packages disclosure is on the basis of packages agreed during the year.	Agreed	Jonathan Lloyd	Immediate
Financial statements disclosures	As set out in the Key Audit and Accounting Matters section of this report, we identified a number of disclosure misstatements in the financial statements, including some material disclosure misstatements.	It is recommended that during the financial statements preparation for 2018/19 year management revisit the disclosure misstatements identified in the 2017/18 year to ensure that no similar misstatements present.	Agreed	Jonathan Lloyd	April 2019

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
STATEMENT OF ACCOUNTS AND FINANCIAL STATEMENTS					
Identification of revenue expenditure funded from capital under statute (REFCUS)	As set out on page 17, we have identified two instances where expenditure has been capitalised within additions to PPE when these expenses should have been recognised as REFCUS. Whilst we consider that recognition of expenditure incurred in respect of the school converted to an academy in REFCUS is judgemental to some extent, expenditure incurred in the prior year in respect of the railway station project was already recognised in REFCUS (in the prior year). Omitting expenditure from being recognised in REFCUS could result in material misstatement in the financial statements.	We recommend that expenditure schedules identified as being REFCUS be subject to second review within the financial accounts team, and this review should incorporate comparison to prior year projects where expenditure had already been recognised in REFCUS in the prior year to ensure that similar expenses in the current year are also recognised in REFCUS. Any expenditure relating to schools should be checked to ensure that they have not gained Academy status during the year.	Agreed	Jonathan Lloyd/ Judith Edmonds-Magee	April 2019
Notifying changes to the assets to finance department	As set out on page 9, we identified that an asset has been demolished during the year which was not communicated to the finance department. Not accounting for changes in assets could result in material errors in the financial statements.	It is recommended that a positive confirmation is obtained from the property team confirming the existence of all property assets at the year-end. We also recommend that review of this information is incorporated into the financial accounts close procedure.	Agreed	Jonathan Lloyd/ Judith Edmonds-Magee	April 2019

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
STATEMENT OF ACCOUNTS AND FINANCIAL STATEMENTS					
Bank reconciliation process	During our audit we identified that a number of bank reconciliations had not been prepared on a timely basis (for both school accounts and council's own bank accounts). Furthermore, no bank reconciliations have been formally reviewed and signed off by an appropriate officer. We consider the preparation and review of the bank reconciliation is a fundamental control which can detect incorrect posting into the ledger as well as the transactions omitted from the ledger.	We recommend that bank reconciliations for all bank accounts are prepared and reviewed by an appropriate officer on a timely basis.	Agreed	Gary Thomas	Immediate
NDR appeals provision - settlements made during the year	In the prior year we identified that the Council's financial system, Integra, did not provide information relating to NDR appeals settled during the year. This was due to the amounts settled being offset against the amounts due from rate payers in the Northgate feeder system. As a result, key financial information required for the purpose of the preparation of financial statements was not available and no required information was disclosed in the financial statements. Consequently, we included a recommendation in our audit completion report in the prior year. We have identified the same issue in our audit for the 2017/18 year, and as set out on page 15 this resulted in the presentation of Collection Fund Statement being misstated by £9.7m. This information is also relevant for informed management decisions about the NDR income.	We recommend that a check is completed to identify actual settlements made during the year against successful NDR appeals so that required information is readily available for the financial statements purpose.	Management accepts the recommendation. Consequently we will investigate further and a process, where possible, so that settlements made during the year can be monitored.	Pat Knight	Aim to have in place by 30 September 2018

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
STATEMENT OF ACCOUNTS AND FINANCIAL STATEMENTS					
Related party transactions identification process	As set out on page 13, we identified that the finance department has not been provided with up to date declaration of interest information for members. This information is held by Corporate Services. As a result we identified a number of entities where members had interests there were not subject to a search within Integra finance system to identify any transactions during the year. This could result in required related party relationships and transactions not been disclosed in the financial statements.	It is recommended that Democratic Services works with the Finance Department to develop a process of capturing accurate declaration of interests during the year and at the year end.	Accepted	Jonathan Lloyd/Perry Holmes	Immediate
Controls over user creation and revocation within Bankline system	We identified that no formal process is in place to set up new users and remove users from the Bankline system. Whilst the users cannot complete any transactions due to dual authorisation requirement, and the access was granted to most of the users on view only basis, this could still pose some risks especially when an employee has left the Council but still has access to Council's internal information relating to banking transactions.	We recommend that a formal process is put in place to set up new users and remove users from the Bankline system. A signed user form should be developed, which must be signed by the user's line manager, which could also be used to inform changes such as removing users. A check should be completed on a monthly basis to compare the leavers list supplied by payroll/HR to any active users on the system.	Agreed	Gary Thomas	Immediate

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
STATEMENT OF ACCOUNTS AND FINANCIAL STATEMENTS					
Multiple customer codes (debtor codes)	We identified two instances where a customer had been set up on the Council's finance system, Integra, with multiple customer codes. This could result in incorrect or duplicate accounting entries and errors in the ledger.	We recommend that a review is undertaken to identify whether there are any other similar instances and whether there is any business reason for having multiple customer codes for the same customer. If there is no such business reason, it is recommended that a single code is maintained for each customer.	Agreed	Gary Thomas	Immediate
Car provision and private medical insurance	The Council pays an annual special allowance to senior officers in respect of car provision and private medical insurance. The payment varies depending on the seniority of the officer. These amounts are disclosed within the Council's 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).	We recommend that the pay policy is updated for the correct amounts payable to senior officers and to ensure that the amounts paid are agreed to the pay policy.	Agreed	Carrie McKenzie	Immediate

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
USE OF RESOURCES					
	Through our work we noted that the MTFS was not produced on a timely basis due to the fact that the Head of Financial Planning position was vacant for part of the year, although it is recognised that this was produced on a more timely basis compared to the prior year. The MTFS was updated in September 2017 and covers the period of 2017-2022. As a result the MTFS does not reflect the balanced budget for 2018/19. Through our discussions we noted that there is not a clear link between the MTFS and the Corporate Plan. There is little margin available in reserves and balances to support any further revenue budget overspends or slippage on savings plans. The Council will need to continue to work hard to identify savings and manage the delivery of these in the medium term. Although savings have been identified, these need to be constantly monitored to ensure that they come into fruition.	The MTFS should be updated at the same time that the budget is set for the following year. The MTFS format should be revisited so that there is a clear alignment to the Corporate Plan (i.e. mapping of priorities, objectives and issues). Improve the sophistication of the monitoring of savings schemes, including the assessment of the level of risk associated with the delivery of savings and escalation where necessary based on the level of impact on the financial position. To enhance the visibility of major transformation and savings schemes, consider monitoring these at a Committee level alongside the monitoring of revenue budgets. Review the reserves policy in place and ensure that it remains fit for purpose given the low level of reserves and the small margin available for any future funding gaps.	The MTFS will be refreshed in September, but then updated with the budget report in February 2019, with a view to the annual refresh aligning with the Council Plan refresh. Our ambition over the medium term is for a single document The monitoring process for 2018/19 has evolved to provide a more coherent narrative to explain the pressures, including references to delivery against savings targets. More importantly than that, the focus of the monitoring process will be on formulating more robust management action plans The last iteration of the MTFS included a Reserve Strategy, which we will strengthen in the next iteration, with a view to rebuilding reserves and ensuring a more sustainable financial position	Chief Finance Officer & Head of Finance Strategy Chief Finance Officer & Head of Finance Strategy Chief Finance Office and Head of Finance Strategy	February 2019 Immediate September 2018

APPENDIX II: RECOMMENDATIONS AND ACTION PLAN

We have followed up on the recommendations that we raised in the previous year:

AREA	OBSERVATION AND IMPLICATION	RECOMMENDATION	MANAGEMENT RESPONSE	RESPONSIBLE OFFICER	TIMING
STATEMENT OF ACCOUNTS AND FINANCIAL STATEMENTS					
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 (2015/16), 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 the 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	Completed by end of March 2018 Recommendation cleared.
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	1 November 2017 Recommendation cleared.
School balances	In the prior year (2015/16) 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.	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	31 March 2018 Recommendation cleared.

APPENDIX III: MATERIALITY

MATERIALITY - FINAL AND PLANNING		
	FINAL	PLANNING
Materiality	£10,600,000	£11,000,000
Clearly trivial threshold	£320,000	£330,000

Planning materiality of £11,000,000 was based on 2% of gross expenditure, which was based on the prior year financial statements.

Our materiality levels have not required reassessment since our audit planning. However, these have been updated to reflect actual gross expenditure reported in the draft financial statements presented for audit.

APPENDIX IV: INDEPENDENCE

Under ISAs (UK) and the FRC's Ethical Standard, we are required as auditors to confirm our independence.

We have embedded the requirements of the Standards in our methodologies, tools and internal training programmes. Our internal procedures require that audit engagement leads are made aware of any matters which may reasonably be thought to bear on the integrity, objectivity or independence of the firm, the members of the engagement team or others who are in a position to influence the outcome of the engagement. This document considers such matters in the context of our audit for the year ended 31 March 2018.

Details of services, other than audit, provided by us to the Council during the period and up to the date of this report were provided in our Audit Plan. We understand that the provision of these services was approved by the Audit Committee in advance in accordance with the Council's policy on this matter.

Details of rotation arrangements for key members of the audit team and others involved in the engagement were provided in our Audit Plan.

We have not identified any relationships or threats that may reasonably be thought to bear on our objectivity and independence.

We confirm that the firm, the engagement team and other partners, directors, senior managers and managers conducting the audit comply with relevant ethical requirements including the FRC's Ethical Standard and are independent of the Council.

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

APPENDIX V: FEES SCHEDULE

	2017/18 FINAL PROPOSED £	2017/18 PLANNED £	2016//17 FINAL £	EXPLANATION FOR VARIANCES
Code audit fee	142,451	142,451	142,451	N/A
Fee for reporting on the housing benefits subsidy claim	24,500[1]	9,856	9,188[2]	BDO has been engaged to perform full housing benefit certification work in 2017/18. In the prior year the Council has also engaged a third party contractor to perform certain tasks relating to the certification work.
TOTAL AUDIT AND CERTIFICATION FEES	166,951	152,307	151,639	
Fees for reporting on other 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
Fees for other non-audit services	-	-	-	N/A
NON-AUDIT ASSURANCE SERVICES	7,400	7,400	7,400	
TOTAL ASSURANCE SERVICES	174,351	159,707	159,039	

[1] The amount agreed with management in respect of housing benefit certification work for 2017/18. This is subject to confirmation from PSAA.

[2] This reflects the initial code audit fee. A fee variation of £4,805 subject to confirmation from PSAA.

APPENDIX VI: DRAFT LETTER OF REPRESENTATION

TO BE TYPED ON MEDWAY COUNCIL HEADED NOTEPAPER
BDO LLP
16 The Havens
Ransomes Europark
Ipswich
Suffolk
IP3 9SJ

30 July 2018

Dear Sirs

Financial statements of Medway Council for the year ended 31 March 2018

We confirm that the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2018 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 Audited Bodies within Chapter 2 of the Code of Audit Practice published by the National Audit Office in April 2015, and in particular that the financial statements give a true and fair view of the financial position of the Council as of 31 March 2018 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).

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.

APPENDIX VI: DRAFT LETTER OF REPRESENTATION

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.

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

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 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 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 that we intend to retain our investment in The Local Authorities' Property Fund (CCLA), Lothbury Property Trust and Rockspring Hanover Property Unit Trust for the long term and that there are no circumstances of which we are aware that would require a forced sale within the next 12 months.

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:

APPENDIX VI: DRAFT LETTER OF REPRESENTATION

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): 2.3%
- Rate of increase in salaries: 3.8%
- Rate of increase in pensions: 2.3%
- Rate of discounting scheme liabilities: 2.55%
- 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.

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 internal valuer and accounted for in the financial statements, are reasonable and consistent with our knowledge of the business and current market prices.

We confirm that the carrying value of assets not revalued during the 2017/18 financial year do not materially different from their current value at the year-end.

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 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.

APPENDIX VI: DRAFT LETTER OF REPRESENTATION

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 or member 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
30 July 2018

Barry Kemp
Chairman of the Audit Committee
Signed on behalf of the Audit Committee
30 July 2018

APPENDIX VII: 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 welcomes feedback from external bodies and is committed to implementing all 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 companies), the firm undertakes a thorough annual internal Audit Quality Assurance Review and as a 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 Transparency Report at www.bdo.co.uk.

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