

The Annual Audit Letter for Medway Council

Year ended 31 March 2019

30 August 2019



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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Medway Council (the Council) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 29 July 2019

Our work

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act).

Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Materiality	We determined materiality for the audit of the Council's financial statements to be £10.1 million which is approximately 1.9% of the Council's gross revenue expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements on 1 August 2019.
Whole of Government Accounts (WGA)	At the date of issuing our Annual Audit Letter, our work on the Council's Whole of Government Accounts Return is ongoing, however it will be completed by the mid-September deadline.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.

Executive Summary

Value for Money arrangements We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 1 August 2019.

Certification of Grants We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by the end of November 2019. We will report the results of this and other grants to the Audit Committee separately.

Certificate We are unable to certify that we have completed the audit of the financial statements of Medway Council until we complete our work on the WGA Return, as mentioned on the previous page, for which the deadline is mid-September 2019.

Working with the Council

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered our first year audit with you during June and July, issuing the financial statements opinion one day after the target date of 31 July 2019.
- Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness. We also delivered a bespoke piece of work as part of our value for money conclusion to give you a more detailed insight into your financial standing.
- Sharing our insight – we provided regular Audit Committee updates covering best practice. We also shared our thought leadership reports
- Providing training – we provided your teams with training on financial statements and annual reporting

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

**Grant Thornton UK LLP
August 2019**

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Council's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Council's financial statements to be £10.1 million, which is approximately 1.9% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

No specific other materiality levels were set during the course of our audit.

The scope of our audit

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

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and Annual Governance Statement published alongside the financial statements to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Financial Statements

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Management override of internal controls</p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We identified management override of controls as a significant risk of material misstatement.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> documented the design effectiveness of management controls over journals; analysed the journals listing and determine the criteria for selecting high risk unusual journals; tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration; gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence; evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions. 	<p>We did not identify any instances of management override of controls. However, we noted that management could not provide evidence to demonstrate the operation of an intended control as designed. Additionally, we identified 8 journals which did not comply with the Council's established control procedures.</p> <p>We understand that a new system of electronic journal processing and approval is due for implementation in the later half of 2019 which should address the control failures identified above.</p>
<p>Valuation of land and buildings</p> <p>You revalue your Council Dwellings and Other Land and Buildings on a rolling five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions.</p> <p>Additionally, you need to ensure that the carrying value in your financial statements is not materially different from the current value or the fair value.</p> <p>We therefore identified valuation of Council Dwellings and Other Land and Buildings, particularly revaluations and impairments, as a significant risk of material misstatement.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; evaluated the competence, capabilities and objectivity of the valuation expert; wrote to the valuer to confirm the basis on which the valuation was carried out; challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding; tested revaluations made during the year to ensure that they have been input correctly into your asset register; evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year end. 	<p>The Code of Practice allows a rolling programme of revaluation over a short period, but places a requirement on management to consider and ensure that assets not revalued in year are not materially misstated.</p> <p>Management prepared an asset impairment review to see if any assets not revalued were materially incorrect. However, management's working paper was not sufficiently detailed to allow us to test for reasonableness. We developed our own point estimate and agreed with management's conclusion. We made one recommendation to strengthen future working papers.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Valuation of Pension Fund net liability</p> <p>Your pension fund net liability, as reflected in the balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements.</p> <p>The pension fund net liability is considered a significant estimate due to the size of the numbers involved and the sensitivity of the estimate to changes in key assumptions.</p> <p>We therefore identified valuation of your pension fund net liability as a significant risk of material misstatement.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> gained an understanding of the processes and controls put in place by management to ensure that the pension fund net liability is not materially misstated and evaluate the design of the associated controls; evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; assessed the competence, capabilities and objectivity of the actuary who carried out the pension fund valuation; assessed the accuracy and completeness of the information provided to the actuary to estimate the liability; tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; undertook procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and obtained assurances from auditors of Kent County Council Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements. 	<p>The Court of Appeal ruled in December 2018 that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members. The Government applied to the Supreme Court for permission to appeal this ruling, but permission to appeal was refused in late June 2019. The case will now be remitted back to employment tribunal for remedy. The legal ruling around age discrimination (McCloud - Court of Appeal) has implications not just for pension funds, but also for other pension schemes where they have implemented transitional arrangements on changing benefits.</p> <p>Discussion is ongoing in the sector regarding the potential impact of the ruling on the financial statements of Local Government bodies. Management requested estimates from their actuary of the potential impact of the McCloud ruling. The actuary's estimate was of a possible increase in past service cost and overall pension liabilities of £5.6m and the possible impact on Cost of Services of £0.6m. Management's view was that the impact of the ruling was not material to Medway Council's financial statements and will be considered for future years' actuarial valuations.</p> <p>In conjunction with auditor's experts, we reviewed the analysis performed by Barnett Waddingham to consider whether the approach that was taken to arrive at these estimates is reasonable. No issue was noted in this review. Although we were of the view that there was sufficient evidence to indicate that a liability was probable, we noted the amount involved was not material. We also acknowledged the significant uncertainties relating to the estimation of the impact on the Council's liability. We reported this as an uncertainty in our Audit Findings Report issued in July 2019.</p> <p>We did not identify any material issues in respect of the valuation of the pension fund net liability.</p>

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Council's financial statements on 1 August 2019.

Preparation of the financial statements

The Council presented us with draft financial statements in accordance with the national deadline, and supported the statements with requested working papers. The finance team responded to our queries during the course of the audit.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Council's Audit Committee on 29 July 2019. We had not identified any adjustments to the Council's Comprehensive Income and Expenditure Statement.

We identified two material audit adjustments in relation to classification and some disclosure amendments. We also identified five unadjusted errors which were not material, individually or in aggregate. Management has not amended the accounts in respect of these errors.

We raised four medium recommendations for management as a result of our audit work

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. It published these on its website alongside the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

At the date of issuing our Annual Audit Letter our work in this area is still outstanding, however this will be completed by the statutory deadline of mid September.

Certificate of closure of the audit

We are unable to certify that we have completed the audit of the financial statements of Medway Council until we complete our work on the WGA Return.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out overleaf.

Overall Value for Money conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	Findings and conclusions
<p>Financial sustainability</p> <p>At the end of quarter 3 of 2018/19, you were forecasting an adverse variance to budget of £2.9 million. At the time, the variances ranged from £2.8 million adverse within Children and Audit Services to a favourable variance of £1 million within Business Support Department. The most significant budget pressure at the time was within Children Services (£1.9 million) largely due to increasing number of placements.</p>	<p>Summary</p> <ul style="list-style-type: none"> • Overall, the achievement of in year financial targets was as a result of a number of key factors including income receipts being greater than planned. The Council recognises some of the factors were non recurrent and reliance on these is not sustainable in the short to medium term. • Demand for Adult and Children services are likely to continue their upward trajectory and as such, continue to place an element of risk to 2019/20 plans should similar levels of overspends arise.
<p>Medium Term Financial Planning</p> <p>In the context of tightening central government funding over recent years and rising demand for your services, you have identified the need to close a revenue budget gap of £16 million over the next four years. You will be required to make significant savings in areas where these have not previously been necessary. Additionally, with the UK due to leave the European Union on 29 March 2019, there will be national and local implications resulting from Brexit that will impact on you.</p>	<p>Summary</p> <ul style="list-style-type: none"> • The Council set a balanced budget for 2019/20 and the detailed planning in respect of 2020/21 is already underway. • Its planned savings target are ambitious and are predicated on achieving its 2019/20 financial target. If it experiences similar levels of overruns in 2018/19 from Adult and Children services, the Council may have to use reserves to achieve financial balance. • Starting the financial year without having identified how all the required savings will be achieved, increases the risk of non delivery of the agreed budget. • The level of general fund and earmarked reserves are below the average when compared to other Kent Authorities.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

Reports issued

Report	Date issued
Audit Plan	21 March 2019
Audit Findings Report	29 July 2019
Auditor's opinion on accounts	1 August 2019
Auditor's value for money conclusion	1 August 2019
Annual Audit Letter	30 August 2019
Housing Benefit Grant Certification and report	November 2019 (planned)

Fees for audit and non-audit services

	Planned fees £	Actual fees £	2017/18 fees £
Statutory audit	109,687	120,687	142,451
Housing Benefit Grant Certification	20,000*	TBC	24,500
Teachers' Pension Return	4,200	TBC	4,200
Pooling Housing Capital Receipts	3,200	TBC	3,200
Total fees	137,087	TBC	174,351

- * Fee estimate to be finalised

Non-audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place.

The non-audit services listed are consistent with the Council's policy on the allotment of non-audit work to your auditor.

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £109,687 assumes that the scope of the audit does not significantly change. There are a number of areas such as pension and PPE valuation, where the scope of the audit changed, which led to additional work. The additional fee agreed with management of £11,000 is subject to approval by PSAA.

We started our work on the Certification of the Council's Housing Benefit Return in August 2019, and will confirm the final fee once the work is completed.

Our commitment to our local government clients

- Senior level investment
- Local presence enhancing our responsiveness, agility and flexibility.
- High quality audit delivery
- Collaborative working across the public sector
- Wider connections across the public sector economy, including with health and other local government bodies
- Investment in Health and Wellbeing, Social Value and the Vibrant Economy
- Sharing of best practice and our thought leadership.
- Invitations to training events locally and regionally – bespoke training for emerging issues
- Further investment in data analytics and informatics to keep our knowledge of the areas up to date and to assist in designing a fully tailored audit approach

Our relationship with our clients– why are we best placed?

- We work closely with our clients to ensure that we understand their financial challenges, performance and future strategy.
- We deliver robust, pragmatic and timely financial statements and Value for Money audits
- We have an open, two way dialogue with clients that support improvements in arrangements and the audit process
- Feedback meetings tell us that our clients are pleased with the service we deliver. We are not complacent and will continue to improve further
- Our locally based, experienced teams have a commitment to both our clients and the wider public sector
- We are a Firm that specialises in Local Government, Health and Social Care, and Cross Sector working, with over 25 Key Audit Partners, the most public sector specialist Engagement Leads of any firm
- We have strong relationships with CIPFA, SOLACE, the Society of Municipal Treasurers, the Association of Directors of Adult Social Care and others.

New opportunities and challenges for your community

The Local Government economy

Local authorities face unprecedented challenges including:

- Financial Sustainability – addressing funding gaps and balancing needs against resources
- Service Sustainability – Adult Social Care funding gaps and pressure on Education, Housing, Transport
- Transformation – new models of delivery, greater emphasis on partnerships, more focus on economic development
- Technology – cyber security and risk management

At a wider level, the political environment remains complex:

- The government continues its negotiation with the EU over Brexit, and future arrangements remain uncertain.
- We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.
- We will keep you informed of changes to the financial reporting requirements for 2019/20 through on-going discussions and invitations to our technical update workshops.

Delivering real value through:

- Early advice on technical accounting issues, providing certainty of accounting treatments, future financial planning implications and resulting in draft statements that are 'right first time'
- Knowledge and expertise in all matters local government, including local objections and challenge, where we have an unrivalled depth of expertise.
- Early engagement on issues, especially on ADMs, housing delivery changes, Children services and Adult Social Care restructuring, partnership working with the NHS, inter authority agreements, governance and financial reporting
- Implementation of our recommendations have resulted in demonstrable improvements in your underlying arrangements, for example accounting for unique assets, financial management, reporting and governance, and tax implications for the Cornwall Council companies
- Robust but pragmatic challenge – seeking early liaison on issues, and having the difficult conversations early to ensure a 'no surprises' approach – always doing the right thing
- Providing regional training and networking opportunities for your teams on technical accounting issues and developments and changes to Annual Reporting requirements
- An efficient audit approach, providing tangible benefits, such as releasing finance staff earlier and prompt resolution of issues.

Grant Thornton in Local Government

Our client base and delivery



- We are the largest supplier of external audit services to local government
- We audit over 150 local government clients
- We signed 95% of our local government opinions in 2017/18 by 31 July
- In our latest independent client service review, we consistently score 9/10 or above. Clients value our strong interaction, our local knowledge and wealth of expertise.

Our connections



- We are well connected to MHCLG, the NAO and key local government networks
- We work with CIPFA, Think Tanks and legal firms to develop workshops and good practice
- We have a strong presence across all parts of local government including blue light services
- We provide thought leadership, seminars and training to support our clients and to provide solutions

Our people



- We have over 25 engagement leads accredited by ICAEW, and over 250 public sector specialists
- We provide technical and personal development training
- We employ over 80 Public Sector trainee accountants

Our quality



- Our audit approach complies with the NAO's Code of Audit Practice, and International Standards on Auditing
- We are fully compliant with ethical standards
- Your audit team has passed all quality inspections including QAD and AQR

Our technical support



- We have specialist leads for Public Sector Audit quality and technical
- We provide national technical guidance on emerging auditing, financial reporting and ethical areas
- Specialist audit software is used to deliver maximum efficiencies



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