The Annual Audit Letter for Shepway District Council

Year ended 31 March 2017

October 2017

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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work we have carried out at Shepway District Council (the Council) for the year ended 31 March 2017.

This Letter provides a commentary on the results of our work to the Council and its external stakeholders, and highlights issues 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 (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit and Governance Committee (as those charged with governance) in our Audit Findings Report on 1 September 2017.

Our 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 and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 7 September 2017.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2017. We reflected this in our audit opinion on 7 September 2017.

Use of additional powers and duties

We are required under the Act to give electors the opportunity to raise questions about the Council's accounts and we consider and decide upon objections received in relation to the accounts. We have two outstanding objections from 2015/16 which we are currently finalising.

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 30 November 2017.

We will report the results of this work to the Audit and Governance Committee in our Annual Certification Letter.

Working with the Council

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
October 2017

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we applied the concept of materiality to determine the nature, timing and extent of our work, and to evaluate 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 our audit of the Council's accounts to be £1.7 million, which is 2% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

The scope of our audit

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

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by the Corporate Director of Organisational Change are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts included in the Statement of Accounts on which we gave our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe 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 accounts

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
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Shepway District Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including Shepway District Council, mean that all forms of fraud are seen as unacceptable. Regardless of this we carry out the following work in relation to this risk: • Reviewed the revenue recognition policies; • Reviewed accounting estimates, judgments and decisions made by management and review any unusual significant transactions • Substantively tested a sample of grant and other revenues	Our audit work did not identify any issues in respect of revenue recognition.
Valuation of property plant and equipment The Council revalues its assets on a rolling basis over a five year period. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from the current value. This represents a significant estimate by management in the financial statements.	We have undertaken the following work in relation to this risk: • Assessed the revaluation control environment and carried out a walkthrough to confirm that controls have been implemented • Reviewed the competence, expertise and objectivity of management experts used, the instructions issued to valuation experts and the scope of their work • Discussed with valuer the basis on which the valuation is carried out and challenged the key assumptions • Reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding • Reviewed management's processes and assumptions for the calculation of the estimate • Tested revaluations made during the year to ensure they are input correctly into the Council's 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 • Reviewed the disclosures made by the Council in its financial statements to ensure they are in accordance with the requirements of the CIPFA Code of Practice and IFRS	Our audit work did not identify any issues in respect of the valuation of property, plant and equipment.

Audit of the accounts

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of pension fund net liability The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements	We have undertaken the following work in relation to this risk: • Identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We also assessed whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement • Reviewed the competence, expertise and objectivity of the actuary who carried out your pension fund valuation. We gained an understanding of the basis on which the valuation is carried out • Undertook procedures to confirm the reasonableness of the actuarial assumptions made • Reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary • Enquired about any data which was provided to the actuary in making their valuation and we reviewed the reasonableness and accuracy of this data	Our audit work did not identified any issues in respect of the valuation of the pension fund net liability. However, we identified that the discount rate factor used by the actuary, Barnett Waddingham, is outside of the auditors expert assessment and we performed additional procedures to confirm the factor used and variance is reasonable.
Changes to the presentation of local authority financial statements CIPFA introduced changes to the 2016/17 Code of Practice during the year to improve the accessibility of the financial statements. The changes affect the presentation of income and expenditure in the financial statements and associated disclosure notes. A prior period adjustment (PPA) to restate the 2015/16 comparative figures is also required.	We have undertaken the following work in relation to this risk: • Documented and evaluated the process for the recording the required financial reporting changes to the 2016/17 financial statements • Reviewed the re-classification of the Comprehensive Income and Expenditure Statement (CIES) comparatives to ensure that they are in line with the Authority's internal reporting structure • Reviewed the appropriateness of the revised grouping of entries within the Movement In Reserves Statement (MIRS) • Tested the classification of income and expenditure for 2016/17 recorded within the Cost of Services section of the CIES • Tested the completeness of income and expenditure by reviewing the reconciliation of the CIES to the general ledger • Tested the classification of income and expenditure reported within the new Expenditure and Funding Analysis (EFA) note to the financial statements • Reviewed the new segmental reporting disclosures within the 2016/17 financial statements to ensure compliance with the CIPFA Code of Practice	There were a number of errors and issues found in the new presentation of the these statements and in the new Expenditure and Funding Analysis note. Once these were corrected, our audit work did not identify any further issues in respect of the risk identified.

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 7 September 2017, in advance of the 30 September 2017 national deadline.

The Council made the accounts available for audit in line with the agreed timetable. There were some delays in the initial fieldwork due to difficulties in isolating populations for testing and in tying the Council's working papers into the general ledger and accounts. The audit team have since met with the Council's finance team to carry out a detailed and collaborative debrief and forward planning session.

Although out audit work did not highlight any adjustments which affected the overall financial position, there were quite a significant number of changes to classifications of items and to disclosures. We also made an adjustment to the Group Balance Sheet where the consolidation accounting entries had not been made correctly (this did not affect the overall Group financial position).

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit and Governance Committee on 26 July 2017 and an updated Audit Findings Report with the final messages of the audit on 1 September 2017. Two control weakness around small value expenditure items and soft loans which were incorrectly retained in the accounts were highlighted in our work and we made recommendations to improve controls here. Additionally, we made recommendations around improving the clarity of records supporting the calculation of HRA depreciation and applying a practical de-minimus for accruals. Management agreed all these recommendations and provided a reasonable timescale to implement the improvements within the 2017-18 financial year.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2016 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.

Key findings

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

The key risks we identified and the work we performed are set out in table 2 overleaf.

Overall VfM 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 2017.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
Medium term financial resilience *Revenue Funding Gap* This financial year the Council is on track to achieve a £1.4m deficit outturn on its General Fund; this being a positive variance against an initial budget deficit of £3.9m. However, looking further ahead the latest version of the MTFS (published in August 2016) sets out a cumulative deficit position of around £3 million over the next four years primarily caused by the gradual reduction and then ceasing of Central Government revenue through to 2019/20. This gap in funding represents a significant challenge for the Council. To help address these challenges the Council is moving forward with a series of business process engineering reviews and is focused on maximising its revenue earning opportunities, for example, the acquisition of land at Otterpool Manor Farm. *Capital Investment* As part of your plan to benefit residents and to increase revenue funding for the region you have ambitious capital plans proposed in the form of a large Otterpool Park Garden City, and the redevelopment of Princess Parade. Both of these proposed developments have significant potential to bring funds into the area through housing and employment, but there are downside risks if not managed appropriately. The plans will require significant borrowing and careful treasury management and it is imperative that financial planning is robust and long term benefits can be demonstrated. In March 2016 the government produced Statutory Guidance on the Flexible Use of Capital Receipts. This provides for greater flexibility in the use of capital receipts. Given the greater flexibility there is more opportunity and risk attached to the Council's arrangements for delivery of strategic priorities.	• We reviewed the Council's arrangements for updating and developing its medium term financial planning, including the actions proposed to address the medium term financial shortfall. • We reviewed managements sensitivity analysis carried out to ensure that alternative outcomes are considered in the medium term planning. • We reviewed the governance arrangements and decision making processes which are planned before these large capital investment plans are approved. • We reviewed how the council has measured the public and financial benefits of these capital investments.	***Revenue funding gap*** *The Council achieved a better outturn position for 2016/17 than planned. The original budget showed a deficit of £3.9m and the outturn was an underspend of £1.45m. The reasons for the improved performance has been reported in the 2016/17 outturn report n July 2017.* *The Cabinet considered and approved the Council's final General Fund budget for 2017/18 and the council tax requirement at its meeting on 22 February 2017. This was then ratified by Full Council later that evening. The Council worked hard to close the original budget gap in 2017/18, moving from a medium term strategy funding gap of £1.54m to a balanced budget by year end. However, the budget does include a planned contribution from reserves of £1.59m which will see the General Fund reserve reduced to £3.9m by 31/3/18 and without this the outturn position is a deficit.* *Due to the East Kent merger proposals falling through in March 2017 the Council has had to reassess its revenue budget and future funding gaps. It is looking increasingly difficult to balance the budget in the future and there are large gaps in the MTFS proposals. Management has been realistic in its reporting to members and has identified that a different course of action is required to ensure that the budget is balanced in 2018/19 and beyond. As the Council is putti arrangements in place about the budget gap we are satisfied* ***Capital Investment*** *The Council is progressing with its capital investment plans although it is recognised that these are still at an early stage during the year. The Council has put in place proper arrangements for making decisions about the capital developments through its reporting to members. Governance arrangements are understood by key officers.* *The consultation with the public is made through its website.* *The Council needs to ensure that governance arrangements are maintained as the projects develop beyond the initial stages and that transparency is maintained. A full business case process should be used.* *There needs to be robust project and capital budget monitoring in place to ensure that the developments do not slip from the agreed timetables.* Based on our work we have found no evidence that the Council does not have proper arrangements and therefore the risk is mitigated.

Appendix A: Reports issued and fees

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

Fees

	Proposed fee £	Actual fees £
Statutory audit of Council	60,458	60,458
Challenge work	TBC	TBC
Housing Benefit Grant Certification	11,166	TBC
Total fees (excluding VAT)	**71,264**	**TBC**

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA)

Reports issued

Report	Date issued
Audit Plan	6 March 2017
Audit Findings Report	1 September 2017
Annual Audit Letter	October 2017

Fees for other services

Service	Fees £
Audit related services: • Certification of housing pooling capital receipts return	**2,000**
Non-audit services East Kent Partnerships Workshops	**3,783**

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 other services which were identified.
- We have considered whether other 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, as reported in our Audit Findings Report.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor and have been approved by the Audit Committee.

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