SOUTHEND-ON-SEA BOROUGH COUNCIL

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2017

26 October 2017

EXECUTIVE SUMMARY

PURPOSE OF THE LETTER

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

RESPONSIBILITIES OF AUDITORS AND THE TRUST

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's (NAO's) Code of Audit Practice (the Code), and to review and report on:

- The Council's and pension fund's financial statements
- Whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the audit.

BDO LLP
26 October 2017

AUDIT CONCLUSIONS

FINANCIAL STATEMENTS

We issued our unmodified true and fair opinion on the Council's financial statements on 15 September 2017.

We reported our detailed findings to the Audit Committee on 6 September 2017.

Our audit identified one material misstatement in respect of the indexation applied to council dwellings. This has increased net assets by £8.195m and unusable reserves by £7.582m and decreased the deficit on the provision of services by £0.613m. This has not impacted on the closing General Fund or Housing Revenue Account (HRA) reserve balances.

We reported on three uncorrected misstatements which management and the Audit Committee concluded were immaterial.

USE OF RESOURCES

We issued our unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 15 September 2017.

Whilst the Council has identified a significant funding gap, appropriate action is being taken to ensure the matter is addressed and the Council has a track record of achieving its financial plans. Sufficient reserves and balances are available to support the Council's services in the medium term, should there be under performance against savings plans.

FINANCIAL STATEMENTS

OPINION	We issued our unmodified true and fair opinion on the Council's financial statements on 15 September 2017.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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

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

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

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

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

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
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 respect of the existence (recognition) of fees and charges included as revenue in the comprehensive income and expenditure statement (CIES).	Our review of revenue recognition focused on testing the existence of fees and charges across all service areas within the CIES. We substantively tested an extended sample of fees and charges to confirm that income had been accurately recorded and earned in the year. We substantively tested an extended sample of year-end debtor balances to confirm that income had been accurately recorded and earned in the year. We reviewed the Council's policy to only accrue for items with a value of greater than £5,000 and made an assessment of whether this could lead to a material misstatement.	We identified that £1.006m of income which the Council had given to schools/colleges was incorrectly consolidated into the Council's CIES as external schools income. We identified 3 schools/colleges for which the income had been consolidated incorrectly. The amounts involved were individually immaterial with the only non-trivial amount being in relation to Seabrook College. The Council has adjusted for this error. We identified two transactions that had not been accrued at 2015/16 year-end. We concluded the potenial extrapolated error to be a misstatement of £507,000. We identified two transactions that had not been accrued at 2016/17 year-end. We concluded the potential extrapolated error to be a misstatement of £290,000. We concluded that the likelihood of the policy to only accrue for items with a value of greater than £5,000 resulting in a material misstatement is remote.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
Property, Plant and Equipment Valuations Local authorities are required to ensure that the carrying value of property, plant and equipment (PPE) is not materially different to the fair value at the balance sheet date. The Code requires management to carry out a full valuation of its land and buildings on a periodic basis (at least every five years). In the intervening years, management is required to assess whether there has been a material change in the value of its assets which should be accounted for. 2016/17 is also the first year in which the Council has used the current valuers, of which we have no prior experience, which increases the associated audit risk.	We reviewed the instructions provided to the valuer and reviewed the valuer's skills and expertise in order to determine if we could rely on the management expert. We confirmed that the basis of valuation for assets valued in year was appropriate based on their usage. We confirmed that an instant build modern equivalent asset basis has been used for assets valued at depreciated replacement cost. We reviewed the indices applied by the Council, and confirmed that the basis used for calculating them was appropriate. We reviewed valuation movements against indices of price movements for similar classes of assets and followed up valuation movements that appeared unusual against indices.	From our review of the instructions provided to the valuer and assessment of the expertise of the valuer, we were satisfied that we can rely on the majority of their work. However our review of the valuation assumptions applied concluded that the value of council dwellings was materially understated. We worked with the Council's internal valuer using local data which indicated the uplift should be 6%, instead of the 3.5% that had been used. This has increased the value of council dwellings by £8.2m and the revaluation reserve by £7.6m. It has also decreased the deficit on the provision of services by £0.6m. We also identified 27 assets which had not been revalued within the last five years and 12 assets which have never been revalued. In response to this, the Council arranged for the 9 highest value assets to be revalued and accounted for as such. This left 30 assets which had not been revalued with a total net book value of £1.657m. We assessed that the value of these assets would not move by a material amount if a revaluation had been undertaken.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
Pension liability assumptions The pension liability comprises the Council's share of the market value of assets held in the Essex Pension Fund and the estimated future liability to pay pensions. An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation. Management has agreed the assumptions made by the actuary to support the estimate and these are disclosed in the financial statements. There was a risk the valuation is not based on accurate membership data or uses inappropriate assumptions to value the liability. We increased the risk from a normal risk to a significant risk following a review of assumptions used by the actuary for the valuation of the present value liability to pay future pensions.	We agreed the disclosures to the information provided by the pension fund actuary. We requested assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary. We checked whether any significant changes in membership data were communicated to the actuary. We reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data.	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. Our review of the assumptions used to calculate the present value of future pension obligations concluded that, overall, they were reasonable.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
Changes in presentation of the financial statements The Code requires a change to the presentation of some areas of the financial statements. This includes: • change to the format of the Comprehensive income and Expenditure Statement (CIES) • change to the format of the Movement in Reserves Statement • new Expenditure and Funding Analysis (EFA) note • change to the Segmental Reporting note • new Expenditure and Income analysis note. These changes required a restatement to the 2015/16 CIES. There was a risk that these presentational changes were not correctly applied in the financial statements.	We reviewed the draft financial statements and checked these against the CIPFA Disclosure Checklist to ensure that all of the required presentational changes have been correctly reflected within the financial statements. We confirmed that the analysis by service in the CIES is consistent with the internal reporting within the Council. We reviewed the restatement of the comparative 2015/16 information to ensure that this was presented consistently with the current year basis.	We identified that the methodology used in the Expenditure and Funding Analysis Note was different between the current and prior periods. This was adjusted with no net impact on the position reported.

FINANCIAL STATEMENTS

OUR APPLICATION OF MATERIALITY

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

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

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

The materiality for the financial statements as a whole was set at £7.7 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 2 per cent) which we consider to be one of the principal considerations for the Council in assessing financial performance.

AUDIT DIFFERENCES

Our audit identified one material misstatement in respect of the indexation applied to council dwellings. Adjusting for this increased net assets by £8.2m and unusable reserves by £7.6m and decreased the deficit on the provision of services by £0.6m. This did not impact on the closing General Fund or Housing Revenue Account (HRA) reserve balances.

There were three unadjusted audit differences in respect of the:

- prior period bad debt provision being overstated, as given information now available to the Council it was concluded that the prior year bad debt provision was overstated by £1.7m. This has no overall financial impact as adjusting this would result in the currect year's bad debt provision contribution being increased to arrive at the same final position
- prior period income within the cost of services being understated by an extrapolated £0.5m, due to income items relating to the prior period being recognised in the current year, as they were not accrued for in the prior period. This had no overall financial impact, as the income should have been included in the prior year and therefore the brought forward balances would have been higher
- extrapolated understatement of adult social care income by £0.3m due to income from client contributions relating to the current period being recognised in 2017/18, rather than being accrued for in the current year

Two of these differences had no impact on the overall financial position, as they relate to timing differences between years. If corrected the final difference would increase net assets and decrease the deficit on the provision of services by £0.3m.

We consider that these uncorrected misstatements do not have a material impact on our opinion on the Council's financial statements.

FINANCIAL STATEMENTS

OTHER MATTERS WE REPORT ON

Strategic report

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

Annual governance statement

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

INTERNAL CONTROLS

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

WHOLE OF GOVERNMENT ACCOUNTS

Auditors are required to review Whole of Government Account (WGA) information prepared by component bodies that are over the prescribed threshold of £350 million in any of: assets (excluding certain non-current assets); liabilities (excluding pension liabilities); income or expenditure.

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

The DCT has been amended as a result of the audit to reclassify the small number of balances amended by the audit to make them consistent with the final financial statements.

AUDIT CERTIFICATE

The audit certificate to close the audit will be issued upon completion of the WGA submission.

USE OF RESOURCES

CONCLUSION	We issued our unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 15 September 2017.

SCOPE OF THE AUDIT OF USE OF RESOURCES

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources based on the following reporting criterion:

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

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

OUR ASSESSMENT OF SIGNIFICANT RISKS

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

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

USE OF RESOURCES

RISK DESCRIPTION	AUDIT FINDINGS	CONCLUSION
Sustainable finances The latest Medium Term Financial Strategy (MTFS) to 2020/21 identified radical changes to Local Government Finance with the moves to 100% localisation of business rates and the ending of Revenue Support Grant. The MTFS has also taken account of expected annual inflationary and pay award pressures, impact of interest rates, the on-going effect of existing policies, pressures and growth in priority services. Budget gaps have been identified in 2018/19 (£10.3 million), 2019/20 (£5.1 million) and 2020/21 (£7.5 million), this is after the assumption that £6.9m savings will be achieved. Delivering the required savings from 2017/18 will be a challenge and is likely to require implementation of difficult decisions around service provision and alternative delivery models. There is a significant risk that this will not be achieved, impacting on the financial sustainability of the Council in the medium term.	We reviewed the latest MTFS which covers the four year period to 2020/21. The Council set a balanced budget for 2017/18 but this required planned savings of £6.9m to be achieved. The MTFS forecasts a budget gap totalling £22.9m over the remaining three years which will need to be funded through either savings or additional revenue in order to maintain the current general fund position. Although the current budget gap is significant the Council is aware of the importance of finding sustainable savings or new revenue streams. We reviewed the assumptions used in developing the MTFS and found them to be reasonable. A prudent approach to expectations of future government funding has been adopted by the Council. The Council continues to maintain a level of balances and earmarked reserves in accordance with the plans set out in the MTFS. As at 31 March 2017, the General Fund balance was £11m which is within the Director of Finance and Resources recommended range of £10m to £12m. General Fund earmarked reserves were £64m increased from £59m at 31 March 2016. The Council's overall useable reserves, which include the General Fund, HRA, Earmarked Reserves (including schools), have increased by £8m in 2016/17.	Whilst the Council has identified a significant funding gap, appropriate action is being taken to ensure the matter is addressed and the Council has a track record of achieving its financial plans. Sufficient reserves and balances are available to support the Council's services in the medium term, should there be under performance against savings plans. Therefore we are satisfied that the Council has sufficient reserves available and is undertaking appropriate arrangements to manage the budget gap in a way that will ensure the Council remains financially sustainable over the period of the MTFS.

APPENDIX

REPORTS ISSUED

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

REPORT	DATE
Audit plan	21 March 2017
Audit completion report	1 September 2017
Annual audit letter	26 October 2017

FEES

We reported our original fee proposals in our audit plan.

AUDIT AREA	FINAL FEES £	PLANNED FEES £
Audit - scale fees	142,816	142,816
Housing benefits subsidy claim	21,284	21,284
Total audit	**164,100**	**164,100**
Fees for non-audit services	11,700	11,700
Total assurance services	**175,800**	**175,800**

FOR MORE INFORMATION:

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