

Forest Heath District Council

Audit Committee Summary

For the year ended 31 March 2015

Audit Results Report – ISA (UK and Ireland) 260

September 2015



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Section 1

Executive summary

Executive summary – key findings

Audit results and other key matters

The Audit Commission's Code of Audit Practice (the Code) requires us to report to those charged with governance – the Performance and Audit Scrutiny Committee – on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified. This report summarises the findings from the 2014/15 audit which is substantially complete. It includes the messages arising from our audit of your financial statements and the results of the work we have undertaken to assess your arrangements to secure value for money in your use of resources.

Financial statements

- ▶ As of 10 September 2015, we expect to issue an unqualified opinion on the financial statements. Our audit work raised a number of queries which resulted in amendments to the accounts. These were classification adjustments which have all been agreed and amended by officers. Our audit results demonstrate, through the few matters we have to communicate, that the Council has prepared its financial statements adequately.

Value for money

- ▶ We expect to conclude that you have made appropriate arrangements to secure economy, efficiency and effectiveness in your use of resources.

Whole of Government Accounts

- ▶ We expect to issue an unqualified confirmation to the National Audit Office (NAO) regarding the Whole of Government Accounts submission.

Audit certificate

- ▶ The audit certificate is issued to demonstrate that the full requirements of the Audit Commission's Code of Audit Practice have been discharged for the relevant audit year. We expect to issue the audit certificate at the same time as the audit opinion.

Section 2

Extent and purpose of our work

Extent and purpose of our work

The Council's responsibilities

- ▶ The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.
- ▶ The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Purpose of our work

- ▶ Our audit was designed to:
 - ▶ Express an opinion on the 2014/2015 financial statements and the consistency of other information published with them
 - ▶ Report on an exception basis on the Annual Governance Statement
 - ▶ Consider and report any matters that prevent us being satisfied that the Council had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the Value for Money conclusion)
 - ▶ Discharge the powers and duties set out in the Audit Commission Act 1998 and the Code of Audit Practice

In addition, this report contains our findings related to the areas of audit emphasis and any views on significant deficiencies in internal control or the Council's accounting policies and key judgments.

As a component auditor, we also follow the NAO group instructions and report the results on completion of the WGA work through the Assurance Statement to the NAO and to the Council.

This report is intended solely for the information and use of the Council. It is not intended to be and should not be used by anyone other than the specified party.

Section 3

Addressing audit risks

Addressing audit risks – significant audit risks

We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the audit of the financial statements is an inherent risk with both a higher likelihood of occurrence and a higher magnitude of effect should it occur and which requires special audit consideration. For significant risks, we obtain an understanding of the entity's controls relevant to each risk and assess the design and implementation of the relevant controls.

Audit risk identified within our audit plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
<p>Risk of management override</p> <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p> <p>For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; ▶ reviewing accounting estimates for evidence of management bias; ▶ evaluating the business rationale for significant unusual transactions; and ▶ reviewing capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised. 	<ul style="list-style-type: none"> ▶ We did not identify any material misstatements, evidence of bias or significant unusual transactions in our testing. ▶ We did not identify any expenditure which had been inappropriately capitalised.
<p>Business rates appeals provision</p> <p>Individual councils now need to provide for rating appeals. This includes not only claims from 1 April 2014 but claims that relate to earlier periods. As appeals are made to the Valuation Office, Councils may not be aware of the level of claims. Council's may also find it difficult to obtain sufficient information to establish a reliable estimate.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ reviewing the Council's provision for business rate appeals to ensure it has been calculated on a reasonable basis in line with IAS37. As part of this we will ensure the provision is supported by appropriate evidence and that the level of estimation uncertainty is adequately disclosed in the accounts. 	<ul style="list-style-type: none"> ▶ The business rates appeals provision accounted for by the Council was deemed to have been calculated on a reasonable basis in line with the requirements of IAS 37.

Addressing audit risks – significant audit risks (cont'd)

- ▶ We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
<p>Group accounting standards</p> <p>The 2014/15 CIPFA Code of Practice introduces new accounting practices in relation to:</p> <ul style="list-style-type: none"> ▶ the specification of new control criteria under IFRS 10 (Consolidated financial statements); ▶ new classification requirements for joint arrangements under IFRS 11 (Joint arrangements); and ▶ the requirements of the new disclosures standard IFRS 12 (Disclosures of interests in other entities). <p>There is a risk that associated group boundary changes may go undetected, and that the required disclosures are not made in accordance with the new standards.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ evaluating management controls in place to ensure all group assessment considerations have been made; and ▶ reviewing the reasonableness of the group assessment against the requirements of the Code and International Financial Reporting Standards (IFRS). 	<ul style="list-style-type: none"> ▶ Our audit work on the Council's group boundary assessment is still in progress.

Addressing audit risks – other audit risks

- ▶ We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
Other audit risks identified from walkthrough testing		
<p>Financial statements closing procedures</p> <p>Our walkthrough of one journal found that the review process was not sufficiently thorough as an incorrect amount had been approved for transfer.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ reviewing journal authorisation procedures to ensure that correct amounts have been approved and agree with supporting documentation. 	<ul style="list-style-type: none"> ▶ Our review of journals and their supporting authorisation and documentation did not raise any issues.
<p>Payroll</p> <p>Our walkthrough identified an amendment (bank account change) that had not been reviewed by a second officer.</p>	<p>Our approach focused on:</p> <ul style="list-style-type: none"> ▶ undertaking predictive analytical review procedures and running our payroll analytics tool to confirm the reasonableness of pay data. 	<ul style="list-style-type: none"> ▶ No material issues were identified from our predictive analytical review and analytics procedures.

Section 4

Financial statements audit – issues and findings

Financial statements audit – issues and misstatements arising from the audit

Progress of our audit

- ▶ The following areas of our work programme are in progress but remain to be completed. We will provide an update of progress at the Performance and Audit Scrutiny Committee meeting:
 - ▶ Receipt of a Letter of Representation
 - ▶ Collection Fund
 - ▶ Income and Expenditure transaction testing
 - ▶ Aspects of disclosure notes
 - ▶ Group accounts
 - ▶ Whole of Government Accounts (WGA)
 - ▶ Post Balance Sheet Events
 - ▶ Executive Director final review of audit work and financial statements
- ▶ Subject to the satisfactory resolution of the above items, we propose to issue an **unqualified audit** report on the financial statements.

Uncorrected misstatements

We have identified 1 error within the draft financial statements which management have chosen not to adjust. This error is brought forward from 2013/14.

We request that this uncorrected misstatement be corrected or a rationale as to why it is not corrected be considered and approved by the Performance and Audit Scrutiny Committee and provided within the Letter of Representation. Appendix A to this report sets out the uncorrected error.

Corrected misstatements

- ▶ Our audit identified a number of further misstatements which our team have highlighted to management for amendment. The significant items corrected during the course of our work are provided at Appendix B.

Other matters

- ▶ As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process including the following:
 - ▶ Qualitative aspects of your accounting practices; estimates and disclosures;
 - ▶ Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions;
 - ▶ Any significant difficulties encountered during the audit; and
 - ▶ Other audit matters of governance interest

We experienced an improvement in the progress of our audit this year due to the joint finance team being fully integrated and the Agresso system being operational all year. Officers were therefore more able to provide prompt responses to the majority of our queries. Officers are already planning ahead to improve next year's closedown process in advance of the accounts deadline moving forwards in 2017/18.

Financial statements audit – application of materiality

Our application of materiality

- ▶ When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	
<p>Planning Materiality and Tolerable error</p>	<p>We determined planning materiality to be £652K (2014: £671k), which is based on 2% of gross operating expenditure reported in the accounts.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p> <p>We set a tolerable error (TE) for the audit. Tolerable error is the application of planning materiality at the individual account or balance level. It is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality. The level of tolerable error drives the extent of detailed audit testing required to support our opinion.</p> <p>Tolerable error has been calculated at £489k. We have set tolerable error at the upper level of the available range because there were no errors within the 2013/14 financial statements which management chose not to adjust. In addition, the errors identified related only to classification and disclosure issues. We will report corrected misstatements exceeding TE to the Performance and Audit Scrutiny Committee.</p>
<p>Reporting Threshold</p>	<p>We agreed with the Performance and Audit Scrutiny Committee that we would report to the Committee all uncorrected audit misstatements in excess of £34k. This was decreased to £33k on receipt of the draft accounts. (2014: £34k)</p>

Financial statements audit – internal control, written representations and whole of government accounts

Internal control

- ▶ It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.
- ▶ We have tested the controls of the Council only to the extent necessary for us to complete our audit. We are not expressing an opinion on the overall effectiveness of internal control.
- ▶ We have reviewed the Annual Governance Statement and can confirm that:
 - ▶ It complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
 - ▶ It is consistent with other information that we are aware of from our audit of the financial statements.
- ▶ We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

Request for written representations

- ▶ We have requested a management representation letter to gain management's confirmation in relation to a number of matters. There were no additional specific representations required other than the standard representations.

Whole of Government Accounts

- ▶ Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.
- ▶ We are currently concluding our work in this area and will report any matters that arise to the Performance and Audit Scrutiny Committee.

Section 5

Arrangements to secure economy, efficiency and effectiveness

Arrangements to secure economy, efficiency and effectiveness

The Code of Audit Practice (2010) sets out our responsibility to satisfy ourselves that Forest Heath District Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In examining the Council's corporate performance management and financial management arrangements, we have regard to the following criteria and focus specified by the Audit Commission.

Criteria 1 – arrangements for securing financial resilience

- ▶ 'Whether the Authority has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future'
- ▶ Since issuing our Audit Plan on 26 March 2015, we have identified a significant risk in relation to this criteria. The significant risk reflects the size of the budget gap the Council is facing over the next few years, as a result of reduced funding and increasing demands for services. This is in line with the challenges being faced by many other councils across the country.
- ▶ The significant risk we have identified at Forest Heath DC is summarised below:
 - ▶ In its medium term financial strategy (MTFS) approved by Council February 2015, the Council identified a cumulative budget gap of £1.9m over the next three years to 2017/18. The MTFS is based on a number of assumptions. Including an estimate of future levels of Government funding from areas such as revenue support grant and the Business Rates Retention Scheme. The reduction of these, or any other Government funding source in future years, would present a risk to achievement of the Council's future budgets.
- ▶ Our work in response to this risk is summarised in the table on page 16 of this report.
- ▶ Our review of your arrangements to secure financial resilience is substantially complete.
- ▶ The Council continues to plan well to secure its longer term financial resilience, and has robust and prudent plans to address volatility and risks to its future budgets from business rates retention and Government funding.
- ▶ We have no issues to report in relation to this criteria.

Criteria 2 – arrangements for securing economy, efficiency and effectiveness

- ▶ 'Whether the Authority is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity'
- ▶ We did not identify any significant risks in relation to this criteria
- ▶ We have no issues to report in relation to this criteria
- ▶ Our work did not identify any other matters relating to aspects of your corporate performance and financial management framework which are not covered by the scope of the two specified criteria above

Addressing audit risks – significant VFM risks

We identified the following significant VFM risk during our audit. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the value for money conclusion is the risk that the auditor may issue the wrong value for money conclusion. Where auditors identify a significant value for money conclusion risk they will need to undertake additional audit work to enable them to reach an appropriate conclusion.

VFM risk identified	Audit procedures performed	Assurance gained and issues arising
<p>Arrangements for financial resilience – Pressures from economic downturn</p> <p>To date the Council has responded well to the financial pressure resulting from the continuing economic downturn.</p> <p>However, with the Council forecasting a cumulative budget gap of £1.9m by 2017/18, there remains significant financial pressure on the Council's budget and MTFs during the current and forthcoming financial years.</p>	<ul style="list-style-type: none"> ▶ We performed a high level review of the current and future potential financial standing of the Council; ▶ We reviewed the appropriateness of the significant assumptions built into the MTFs; and ▶ We reviewed the level of savings achieved to date and the progress made in identifying savings/efficiency measures in the medium term to bridge the budget gaps present from 2016/17 onwards. 	<p>Through its year end capital and revenue outturn, annual budget setting, use of reserves and its medium term financial planning, the Council continues to plan well to secure its longer term financial resilience. However, along with many other local councils, Forest Heath is facing significant financial challenges over the next three to four years.</p> <p>There have been a number of changes to the way the Council is financed over recent years with external funding sources reducing and new funding mechanisms being introduced. These are subject to change and uncertainty in future years. The Council's financial forecasts that have been reported to Members make clear the scale of the challenge being faced which include a cumulative budget gap of around £1.9 million over the next 3 years (to 2017/18) which will need to be bridged through savings and efficiencies or increased income.</p> <p>Some of the main areas of uncertainty which impact the council relate to:</p> <ul style="list-style-type: none"> ▶ Future levels of business rates income, and the volatility in business rate income forecasts; ▶ Future funding through the New Homes Bonus; and ▶ Level of Government funding through the Revenue Support Grant (RSG). <p>Business rates income forecasting in particular presents a challenge for the Council, adding a significant degree of uncertainty to the Council's funding position in the medium term.</p> <p>The Council has a good track record of delivering savings and meeting its budget. It is acutely aware of the challenges it faces and good progress has already been made on identifying robust savings and efficiency plans to bridge the medium term budget gap. We will continue to review this area during our 2015/16 audit.</p>

Section 6

Independence and audit fees

Independence and audit fees

Independence

- ▶ We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan dated March 2015.
- ▶ We complied with the Auditing Practices Board's Ethical Standards for Auditors and the requirements of the Audit Commission's Code and Standing Guidance. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.
- ▶ We confirm that we are not aware of any relationships that may affect the independence and objectivity of the firm that we are required by auditing and ethical standards to report to you.
- ▶ We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Performance and Audit Scrutiny Committee on 24 September 2015.

- ▶ We confirm that we have met the reporting requirements to the Performance and Audit Scrutiny Committee, as 'those charged with governance' under International Standards on Auditing (UK and Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements were set out in our Audit Plan of March 2015.

Audit fees

- ▶ The table below sets out the scale fee and our final proposed audit fees.

	Proposed final fee 2014/2015	Scale fee 2014/2015	Variation comments
	£	£	
Audit Fee: Code work	62,745	62,745	Final fee to be confirmed.
Certification of claims and returns	18,270	18,270	No change proposed, however claims work is still in progress.
Non-Audit work	0	0	No non-audit work has taken place in 2014/15.

- ▶ Our actual fee is in line with the agreed fee at this point in time, subject to the satisfactory clearance of the outstanding audit work.
- ▶ We confirm that we have not undertaken any non-audit work outside of the Audit Commission's Audit Code requirements.

Section 7

Appendices

Appendix A – uncorrected audit misstatements

- ▶ The following misstatement, which is greater than £33k, has been identified during the course of our audit and in our professional judgement warrant communicating to you as those charged with governance.
- ▶ These adjustments have not been made by management within the revised financial statements.

Balance sheet and statement of comprehensive income and expenditure

Item of account	Nature	Type	Balance sheet	Comprehensive income and expenditure statement
	Description	F, P, J	Debit/(credit)	Debit/(credit)
General Fund	As noted in the 2011/12 Annual Governance Report, the Authority has not valued an element of its property, plant and equipment in accordance with the Code of Practice on Local Authority Accounting ('the Code') by erroneously including Adjudication costs in its valuation. These costs are 'abnormal costs' which are not directly attributable to bringing the asset into use and so should be reported as a cost of service. £394k has been capitalised in previous years.	F	394,000	
Capital receipts reserve	As above			(394,000)
Cumulative effect of uncorrected misstatement			394,000	(394,000)

Key

- ▶ F – Factual misstatement
- ▶ P – Projected misstatement based on audit sample error and population extrapolation
- ▶ J – Judgemental misstatement

Appendix B – corrected audit misstatements

- ▶ The following disclosure misstatements, greater than £489k, have been identified during the course of our audit and in our professional judgement warrant communicating to you.
- ▶ These items have been corrected by management within the revised financial statements

Disclosures

Disclosure	Description of misstatement
1. Note 19 Financial Instruments – Categories of Financial Instruments + Fair Values of Assets and Liabilities	Financial liabilities at amortised cost was overstated by £702k. Financial liabilities at amortised cost was therefore amended from £1,618k to £916k. This also impacts on the financial liabilities disclosed in the Fair Values of Assets and Liabilities table which was amended from £4,067k to £3,365k
2. Note 11 Property, Plant and Equipment – Capital Commitments	Capital commitments for the Home of Horse Racing Trust were understated by £755k. Capital commitments of £2.943m were amended to £3.698m

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ED None

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