Tendring District Council

Annual Audit Letter for the year ended 31 March 2017

October 2017

Ernst & Young LLP

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Contents

Public Sector Audit Appointments Ltd (PSAA) have issued a ''Statement of responsibilities of auditors and audited bodies". It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment (updated 23 February 2017)" issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Tendring District Council (the Council) following completion of our audit procedures for the year ended 31 March 2017.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2017 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources

Area of Work	Conclusion
Reports by exception: ► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council
► Public interest report	We had no matters to report in the public interest
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 15 September 2017 and discussed with the Audit Committee on 21 September 2017
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 22 September 2017

In December 2017 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Kevin Suter
Associate Partner

For and on behalf of Ernst & Young LLP

United Kingdom

Purpose

Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report to the 21 September 2017 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued to the 16 March 2017 Audit Committee and has been conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2016/17 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on you Whole of Government Accounts return. The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned 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.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 22 September 2017.

Our detailed findings were reported to the 21 September 2017 Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Management override of controls A risk present on all audits is that 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. Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.	We did not identify any evidence of material management override. We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation. We had no matters to report. Our review of accounting estimates did not identify any evidence of management bias. We did not identify any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business

Significant Risk	Conclusion
Revenue and expenditure recognition	
Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation. We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end. 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. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.	Our testing did not reveal any material misstatements with respect to revenue and expenditure recognition. Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the Council's financial position. We did not find errors from testing cut-off processes. Our testing did not identify any expenditure which had been inappropriately capitalised.
Other - Presentation of the financial statements	
The Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the Code) this year required changes in the presentation of the financial statements. The new reporting requirements impact the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS). They also include a new 'Expenditure and Funding Analysis' note as a result of the 'Telling the Story' review of the presentation of local authority financial statements. The new Code also required that the service analysis is based on the organisational structure under which the organisation operates.	Our testing did not identify any material misstatements in the 2016/17 statement of accounts. We identified that within the CIES the restated gross expenditure and gross income differed from the 2015/16 financial statements, each by £0.4m. The differences related to netting off external income against recharges. The issue did not have an impact on the previously reported surplus/deficit on the CIES or the general fund. No other issues were identified during our work performed in this area. The change in the Code required a new structure for the primary statements, new notes and a full retrospective restatement of impacted primary statements. Together with investigation of the £0.4 million difference, this meant that we incurred extra costs in performing our audit as anticipated in our 2016/17 Audit Plan.

Other Key Findings	Conclusion
Other - Property, plant and equipment valuations	
Property, Plant and Equipment (PPE) represents a material item on the Council's balance sheet. PPE is initially measured at cost and then revalued to fair value (determined by the amount that would be paid for the asset in its existing use) on a 5 year rolling basis. This is carried out by an expert valuer and is based on a number of complex assumptions. Annually the valuer assesses assets to identify whether there is any indication of impairment. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.	In 2016/17 the Council employed a new valuer, valuing its full portfolio. We assessed and were satisfied with the competency and objectivity of the Council's valuers. We undertook appropriate audit procedures to verify and critically challenge the basis of valuation adopted by the valuer in relation to the Council's property, focusing in particular on specialist assets which are valued on a depreciated replacement costs basis. The Council requested the valuer to value the Council's General Fund (GF) and Housing Revenue Account (HRA) assets as at 1 April 2016. The valuers produced a further report indicating that GF asset values would have increased by below 2%, but by 2.3% for HRA Properties by 31 March 2017. The Council's trigger for assessing whether to amend the accounts is 2%, However, the Council declined to increase HRA values in the context of an overall £126m balance. We accepted as an estimate on this specific account that no further action was required. However, if the Council sets a trigger it should apply it consistently. Such movements may be avoided if the Council moved to a later valuation date than 1 April each year.
Other - Pensions valuations and disclosures	
The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within their financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. The Council's current pension fund deficit is a material and sensitive item and the Code requires that this liability be disclosed on the Council's Balance Sheet. The information disclosed is based on the IAS19 report issued to the Council by the actuaries to the Essex Pension Fund. As part of their actuarial review, Councils are being asked to make additional payments to the pensions scheme to fund deficits.	We have assessed and are satisfied with the competency and objectivity of the Council's actuaries. EY pension's team considered the work of PwC (the Consulting Actuary to the NAO) who reviewed the work of the actuaries. We considered the assumptions used by the actuary and adopted by the Council to be generally acceptable. The sensitivities surrounding these assumptions have been correctly disclosed in Note 31 to the financial statements. We challenged the significant movement in the actuarial valuation and found no indication of management bias in this estimate. However, we do consider that the methodologies used to derive the discount rate and Retail Price Index inflation assumptions to be optimistic and do not take adequate account of the specific duration of the scheme's liabilities. In future years, this could potentially lead to unacceptable assumptions.

Other Key Findings	Conclusion
Other – Narrative Report We reviewed the information presented in the Narrative Report for consistency with our knowledge of the Council.	We recommended that for 2017/18, in order to comply with the Code of Practice, the Council enhances the reporting of non-financial performance information in the Narrative Report to include comparative data for all indicators and to provide a commentary on significant changes between years.

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	Thresholds applied
Planning materiality	We determined planning materiality to be £2.2 million (2015/16 £2.1 million), based on 2% of gross revenue expenditure and interest payable of £112.5 million. We consider gross revenue expenditure on services to be the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.1 million (2015/16 £0.1 million)

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits: Our audit strategy was to check the disclosures and bandings reported in the Council's financial statements, test the completeness of the disclosure and ensure that the disclosures were compliant with the Code Audit Practice. We sample checked transactions back to the payroll system and supporting documentation. Management amended the Remuneration Report to correct mis-allocated payments made as regards Employer's Contributions to Pension; and
- Related party transactions: Our audit strategy was to obtain and review declarations from Audit Committee Members and senior officers for any material disclosures and to ensure the Council's disclosures were compliant with the Code. We carried out a sample check of Companies House searches to identify whether any key decision-makers in the council had any interests in any companies undertaking work for the Council to test the completeness of the disclosure. We had nothing to report from our audit work.
- Members Allowances. Our audit strategy was to test the completeness of the disclosure and make sure that the disclosure was compliant with the Code by sample checking transactions back to the payroll system and the Council's Constitution. No issues were noted.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. There were no uncorrected errors to report.

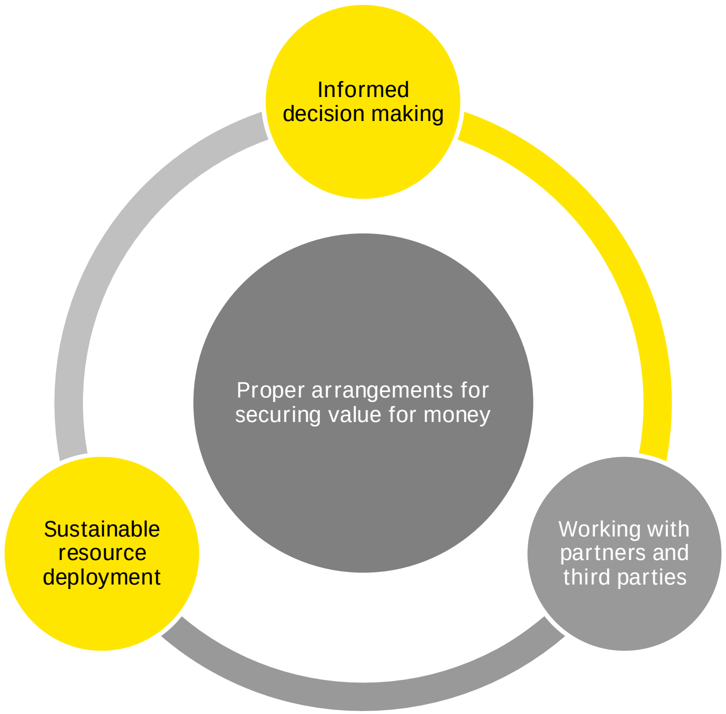
Value for Money

Value for Money

We are required to consider whether the Council has put in place ‘proper arrangements’ to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



Initially, we identified two significant risks in relation to these arrangements, as outlined in our audit plan. During 2017, we identified a new significant risk in respect of a change in established policy for the acquisition of commercial property. We have undertaken audit procedures to address these risks. We did not identify any significant weaknesses in the Council's arrangements to ensure it deployed resources to achieve planned and sustainable outcomes for taxpayers and local people, worked with Partners and Third Parties and took properly informed decisions.

We therefore issued an unqualified value for money conclusion on 22 September 2017. The table below presents the findings of our work in response to this risk.

Significant Risk	Conclusion
Sustainable resource deployment: Financial resilience – achievement of savings needed over the medium term The Council faces significant financial challenges over the next three to four years, with a forecast underlying budget gap of £3.5m by 2019-20. Given the scale of the savings needed, there is a risk that savings plans to bridge this gap are not robust and/or achievable.	The process for setting the Council's budget is sound. We concluded that the Medium Term Financial Plan identifies the key assumptions expected to underpin the 2017/18 budget. We recommended that more detail be provided to show how future budget gaps are derived. The latest September 2017 Cabinet Report addresses this recommendation. We judge that there are no pressing concerns that financial austerity is impacting on Council's performance. Of fourteen key indicators reported, only four are below target for 2016/17: Financial Self-Sufficiency: (£0.558m 2017/18 budget gap covered by reserves); Recycling rates: (25.4% against 29% target); Planning Applications: 40% of major schemes (60% target) and Complaints: 86% completed on time (100% target). The Head of Finance, Revenues and Benefits internal working papers suggest a budget gap of £4.6 million to March 2021. As at 31 March 2017, The Council had identified savings plans to the value of £2.9 million to 31 March 2020, although supporting detailed plans had not all been completed or risk assessed as to success of delivery. As at 31 March 2017 total useable reserves are £29.6 million including the £4 million General Fund reserve. Of these reserves. £16.6 million relate to commitment reserves to fund specific projects by Members. Should these be spent, the remaining earmarked reserves available to the Council are £9 million, which still covers the gap. Therefore, based on the known information as at the end of the financial year, we assess the Council to have adequate arrangements in place to address the gap. Management's September 2017 report sets out a new ten year approach to budgeting, aimed at maximising savings opportunities whilst delivering growth in underlying income to deliver a balanced budget over a ten year forecast. However, this depends upon the use of £3.7 million reserves profiled to 2024/25. Using non-recurrent reserves is not a sustainable approach to addressing budget gaps. The Council needs to secure the income growth and risk assess and deliver its savings plan, especially should austerity continue.

Significant Risk	Conclusion
Work with Partners and Third Parties: Essex Garden Communities Project Over the past eighteen months, the Council jointly with Colchester Borough Council, Braintree District Council and Essex County Council has developed proposals for Garden Communities in North Essex, including one on the Tendring and Colchester border. The aim of the Garden Communities approach is to identify an agreed strategic approach to the allocation and distribution of large scale housing led mixed use development, including employment opportunities and infrastructure provision. As a new and significant arrangement there may be risks relating to the governance and accounting arrangements for the establishment of the project that affect the Council.	We have undertaken the procedures as set out in our audit strategy which have focused on gaining an understanding of the governance structure in place to manage the garden community project. Our work performed demonstrates that the North Essex Garden Communities project between the four Councils is being governed appropriately and that there is a strong working relationship between the parties. The Council has sourced a peer review, performed by Lord Kerslake. The review looked at the current approach to delivering Garden Communities in North Essex. All four Authorities have responded positively and in a timely manner to the recommendations provided in Lord Kerslake's peer review. Given the early stage of the project we are likely to revisit this issue as the project develops.

Significant Risk	Conclusion
Informed decision making: The change in established policy for the acquisition of commercial property In 2015/16, the Council introduced a policy for the purchase of properties for investment. The policy envisaged a modest level of investment with a sum of £0.750m being included within the Capital Programme for property acquisitions. This approach was to enable the Council to reflect on the success of investments to inform future decisions. During our audit, the Head of Finance, Revenues and Benefits informed us that that the Council had the opportunity to acquire a property beyond this level. As a material change to the existing policy we considered there could be risks around the governance arrangements to support the acquisition and the reporting to those Members responsible for taking the decision whether to purchase or not.	As a new risk during the year, we devised an audit strategy and undertook procedures which focused on: • Reviewing the report to Cabinet setting out the details for the terms for the acquisition; • Considering the due diligence report undertaken by management in line with the policy; and • Assessing how the report acknowledged the risks associated with the acquisition to inform Members in their decision-making. Our work highlighted improvements to the report and the due diligence document. In particular, we requested that, to aid their decisions, the report drew Members' attention to the risk that the price of property can fall as well as increase over time and how management aim to mitigate this risk. We note that the intention is for management to report the performance of the portfolio to Members on a half yearly basis with any changes in risk being reported at that point in time. We recommend that management report any significant changes to the terms of the acquisition promptly.

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

Management amended the Annual Government Statement to record the required improvement for risk management as highlighted by Internal Audit and the actions taken to address.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2016/17 financial statements from member of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 21 September 2017. 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 regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in the financial statements. However, we reported the matter below in our Audit Results Report. The matter reported is limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported.

Description	Impact
Our audit work highlighted that neither the Council nor the contractor had signed one of the four contracts which we had tested and that the contract did not specify the contractor.	The Monitoring Officer has confirmed that the legal conditions exist for the contract to be enforceable. However, best practice is for all contracts to be signed by all parties. We note that the contract is due for renewal in 2019. New tendering procedures should ensure signed agreements of contracts as part of the procurement process in future.

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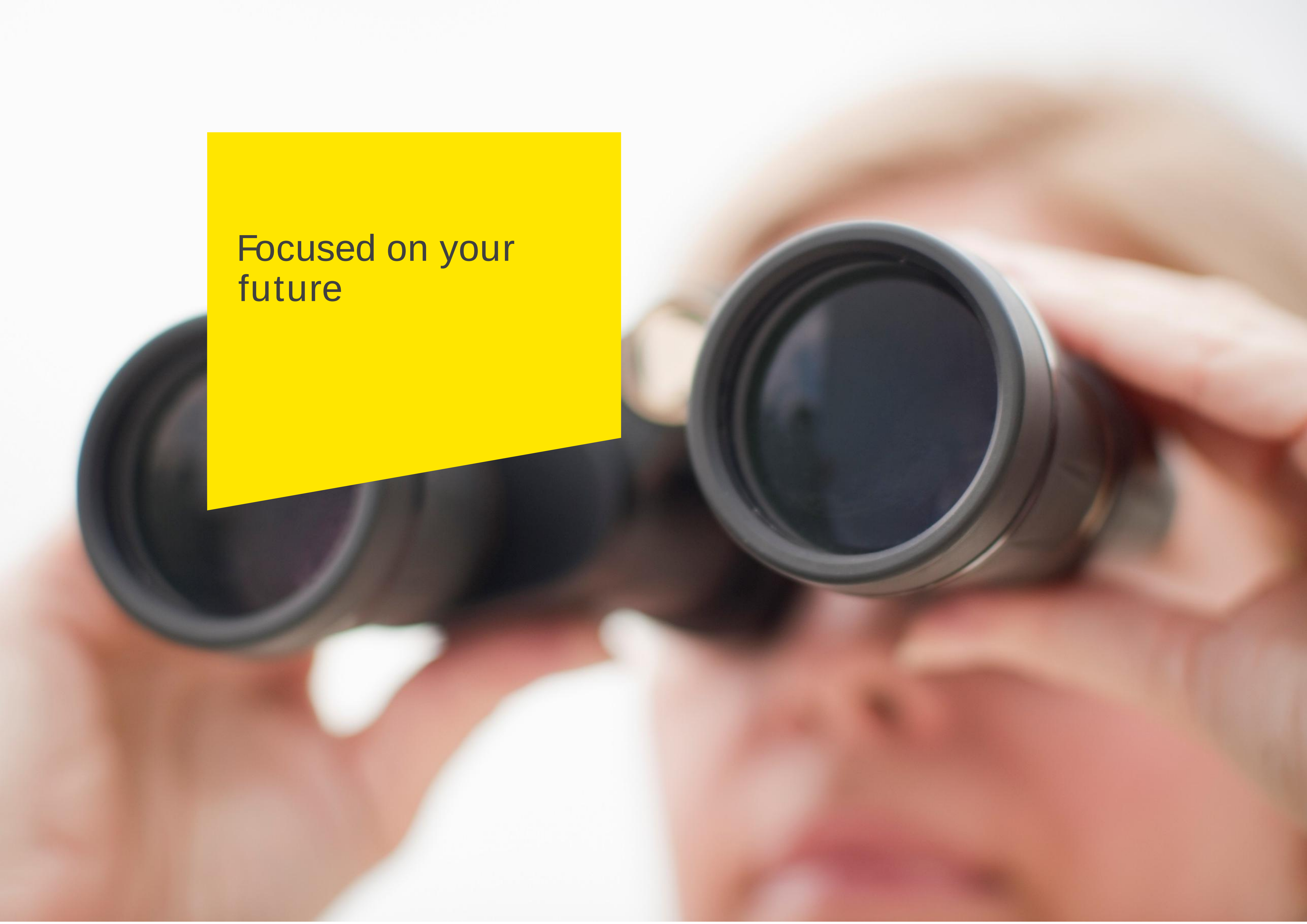

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Area	Issue	Impact
Earlier deadline for production and audit of the financial statements from 2017/18	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.	These changes provide challenges for both the preparers and the auditors of the financial statements. To prepare for this change the Council has reviewed and amended the closedown process over the last year. Through working together, we agreed areas for early work in the 2016/17 audit which included testing of major income and expenditure streams based on information available in December 2016 to reduce testing at the final accounts audit in the Summer. We met with the Council's Finance Team on 21 September to reflect on the closure process for the 2016/17 financial statements. We both identified a number of areas where the closedown and audit processes can be further improved going forward. For 2017/18 we are planning for extensive testing across a number of areas based on November 2017 information, earlier completion of valuation and contract work and also the Value for Money conclusion by 31 March 2018.
Forthcoming changes to accounting standards: *IFRS 9 Financial Instruments* *IFRS 15 Revenue from Contracts with Customers* *IFRS 16 Leases*	Revised accounting standards are expected to be applicable for local authority accounts from the 2018/19 (IFRS 9 (financial Instruments) and IFRS15 (revenue) and 2019/20 financial year IFRS 16 (leases). Transitional arrangements are included within the accounting standards. However as the 2018/19 and 2019/20 Accounting Code of Practice for Local Authorities have yet to be issued it is unclear what the impact on local authority accounting will be and whether any accounting statutory overrides will be introduced to mitigate any impact.	CIPFA issued some initial thoughts on the approach to adopting IFRS 9 and IFRS 15, but until the Code is issued and any statutory overrides are confirmed there remains some uncertainty. For IFRS 16, it is clear is that the Council will need to undertake a detailed exercise to classify all of its leases and therefore must ensure that all lease arrangements are fully documented The Council is awaiting clarification of the exact requirements before investing time in the above work.

Appendix A

Audit Fees

Appendix A Audit Fees

Our March 2017 Audit Plan recorded planned fees for 2016/17 in line with the scale fee set by the PSAA Ltd.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work	To Be Confirmed	58,708	58,708	61,566
Total Audit Fee – Certification of claims and returns	To Be Confirmed	15,475	15,475	13,110

We have undertaken extra work as a result of:

- The findings from changes to Comprehensive Income and Expenditure Statement required by the CIPFA Code of Practice on Local Authority Accounting for 2016-17;
- Our review the governance and reporting process as regards the change policy for the acquisition of commercial properties; and
- An increase in work due to the revaluation of the full asset portfolio, and delayed responses to our requests for asset valuation documentation.

We anticipate a scale fee variation will be necessary, which we will discuss in the first instance with the Head of Finance, Revenues and Benefits. We will update the Audit Committee on our proposed fee variation when this has concluded. Any variation to the 2016/17 scale fee is subject to approval by the PSAA.

Our certification of the housing benefits claim takes place in September and October 2017. We will confirm the final fees charged in our certification report to be issued to the Council in December 2017.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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ED None

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