



EASTBOURNE BOROUGH COUNCIL

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2016



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 financial year ended 31 March 2016. 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 Council

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 Code of Audit Practice (the Code), and to review and report on:

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

We are also required to report where we have exercised our statutory powers under the Local Audit and Accountability Act 2014 in any matter and our grant claims and returns certification work.

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.

Audit conclusions

FINANCIAL STATEMENTS

We issued an unqualified true and fair opinion on the financial statements on 30 September 2016.

We reported our detailed findings to the Audit and Governance Committee on 21 September. We reported on uncorrected misstatements which management and the Audit and Governance Committee concluded were immaterial.

USE OF RESOURCES

We issued an unqualified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 30 September 2016.

While there is a recognised funding gap in the Medium Term Financial Strategy (MTFS), we are satisfied that the Council has appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.

EXERCISE OF STATUTORY POWERS

We have not exercised our statutory powers and have no matters to report.

GRANT CLAIMS AND RETURNS CERTIFICATION

Our review of grant claims and returns for the year ended 31 March 2016 is in progress and the results will be reported upon completion of this work.

FINANCIAL STATEMENTS

OPINION

We issued an unqualified true and fair opinion on the financial statements on 30 September 2016.

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 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 directing of the efforts of the audit team.

REVENUE RECOGNITION	RESPONSE	FINDINGS
Risks of fraud in revenue recognition may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue.	Our review of revenue recognition focused on testing completeness and existence of fees and charges across all service areas in the Comprehensive Income and Expenditure Statement.	No issues were identified.

FINANCIAL STATEMENTS

Continued

GROUP ACCOUNTS	RESPONSE	FINDINGS
<p>The Council has interests in the following entities:</p> <ul style="list-style-type: none"> • Eastbourne Homes Limited (EHL), a wholly owned subsidiary for which the Council has historically prepared Group Accounts • Greencoat House Limited and its wholly owned subsidiary Welbeing, which are associates to the Council • CloudConnX Limited, an associate to the Council • Eastbourne Housing Investment Company Limited (EHIC), a wholly owned subsidiary incorporated during 2015/16. <p>We identified a risk regarding the completeness of the Group Accounts in respect of the Council’s share of transactions in Greencoat House, Welbeing, and CloudConnX Limited and EHIC.</p> <p>We also identified a risk regarding the accuracy of the Group Accounts in respect of the conversion of the group entities’ accounts from Financial Reporting Standards (FRS) 102 to International Financial Reporting Standards (IFRS), as this was the first year of implementation of FRS 102 by the group entities.</p>	<p>We reviewed the financial statements and management accounts of Greencoat, Welbeing, CloudConnX and EHIC, to determine if they needed to be included in the Council’s Group Accounts.</p> <p>We reviewed the Council’s processes and controls for adjusting FRS 102 accounts to IFRS for all group entities.</p> <p>We reviewed the Group Accounts and checked that assets, liabilities, income and expenditure and relevant disclosures were correctly consolidated.</p>	<p>The Council’s share of post acquisition retained earnings in Greencoat House, Welbeing and CloudConnX were not cumulatively material in 2015/16 and therefore the Council continued to account for its investment in these entities at cost.</p> <p>The Council’s two wholly owned subsidiaries, EHL and EHIC, were correctly consolidated in the Group Accounts. Our testing did not identify any issues in respect of the conversion from FRS 102 to IFRS in the consolidation of companies in the Group Accounts.</p> <p>Management should continue to review the Council’s share of transactions in Greencoat House, Welbeing and CloudConnX and, if material, ensure that these companies are consolidated into the Group Accounts.</p>

FINANCIAL STATEMENTS

Continued

PROPERTY VALUATIONS	RESPONSE	FINDINGS
<p><u>Property, plant and equipment (excluding surplus assets)</u></p> <p>Land and buildings included in Property, Plant and Equipment (PPE) are valued based on market values for existing use or depreciated replacement cost (DRC).</p> <p>The Council engaged an external valuer to assess whether there had been a material change in the value of its council dwellings and other land and buildings at 31 March 2016.</p> <p>We identified a risk regarding the appropriateness of these valuations.</p> <p><u>Investment properties and surplus assets</u></p> <p>The Code of Practice on Local Authority Accounting 2015/16 ('the Code') introduced a change in the basis of valuation of investment properties and surplus assets under International Financial Reporting Standard (IFRS) 13, from market value as an investment property or existing use value as a surplus asset, to a 'highest and best use' valuation.</p> <p>The Council engaged an external valuer to value these assets at 31 March 2016.</p> <p>We identified a risk of the valuations failing to take into account the potential alternative uses of the properties.</p>	<p>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.</p> <p>We challenged the valuation methodology applied by the valuer and confirmed the appropriateness of the basis of valuation for assets valued in year.</p> <p>We compared the valuations to expected movements using available market information.</p>	<p>The revaluations resulted in a net increase in PPE of £11.458 million, the majority of which was attributable to indexation on council dwellings, and a net gain of £66,000 on investment properties, due to marginal increases in the market at the year end.</p> <p>We concluded that the basis of the valuations were appropriate and that the valuation movements were within expectations.</p>

FINANCIAL STATEMENTS

Continued

PENSION LIABILITY	RESPONSE	FINDINGS
<p>The pension liability comprises the Council's share of the market value of assets held in the East Sussex Pension Fund and the estimated future liability to pay pensions.</p> <p>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.</p>	<p>We reviewed the reasonableness of the assumptions applied by comparing them to the expected ranges provided by an independent consulting actuary.</p> <p>The key changes to the financial assumptions related to:</p> <ul style="list-style-type: none"> • increase in the salary increase rate from 4% to 4.1% • increase in the discount rate from 3.1% to 3.4% (to place a current value on the future liabilities through the use of a market yield of corporate bonds). 	<p>At 31 March 2016 the net pension liability decreased by £5.915 million, mainly as a result of a change in discount rate applied to the liabilities.</p> <p>We were satisfied that the assumptions used were not unreasonable or outside of the expected ranges.</p>

FINANCIAL STATEMENTS

Continued

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 £2 million. This was determined with reference to a benchmark of gross expenditure (of which it represents two per cent) which we consider to be one of the principal considerations for the Council in assessing the financial performance.

We agreed with the Audit and Governance Committee that we would report all individual audit differences in excess of £40,000.

Audit differences

Our audit found three audit differences not corrected in the final financial statements that impact on the reported surplus:

- £52,000 - Over accrual of information communication technology (ICT) support and maintenance expenditure
- £45,000 - Overstatement of the non domestic rate arrears impairment allowance
- £44,000 - Understatement of the non domestic rates appeals provision (the Council's share).

Correcting for these misstatements would have resulted in the Council reporting a £53,000 higher surplus for the year.

We considered that these misstatements did not have a material impact on our opinion on the financial statements.

The impact of prior year misstatements on current year performance would increase the reported underlying surplus for the current year by £132,000:

- £237,000 over accrual of non domestic rates levy payable corrected in 2015/16
- £105,000 under accrual of non domestic rates section 31 grants corrected in 2015/16.

These amounts remain misstatements with regard to reporting in year financial performance, but are not misstatements at the year end.

Other matters we report on

Annual Governance Statement

We were satisfied that the Annual Governance Statement was not misleading or inconsistent with other information we were aware of from our audit.

Narrative reporting

Local authorities are required to include a Narrative Report in the Statement of Accounts to offer interested parties an effective guide to the most significant matters reported in the accounts. The Narrative Report should be fair, balanced and understandable for the users of the financial statements.

We were satisfied that the information given in the Narrative Report for the year ended 31 March 2016 was consistent with the financial statements.

FINANCIAL STATEMENTS

Continued

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 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.

The Council falls below the threshold for review and there is no requirement for further work other than to submit the section on the WGA Assurance Statement to the WGA audit team with the total values for assets, liabilities, income and expenditure. We submitted this on 30 September 2016, in advance of the national deadline.



USE OF RESOURCES

CONCLUSION

We issued an unqualified conclusion on the arrangements for securing economy, efficiency and effectiveness in its use of resources on 30 September 2016.

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 knowledge brought forward from previous audits, relevant findings from work undertaken in support of the opinion on the financial statements, reports from the Council including internal audit, information disclosed or available to support the Annual Governance Statement and Narrative Report, and information available from the risk registers and supporting arrangements.

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

MEDIUM TERM FINANCIAL STRATEGY	RESPONSE	FINDINGS
<p>The Medium Term Financial Strategy (MTFS) approved by Cabinet in July 2015, covering the four year period from 2016/17 to 2019/20, identified a base funding gap of £2.4 million over the period. This equates to an average level of required savings of £600,000 per annum. The MTFS was updated again in July 2016 and indicated an average level of required savings of £930,000 per annum over the period.</p> <p>We identified a risk that achieving the required level of savings going forward would require further difficult decisions around service provision and alternative service delivery models.</p>	<p>We reviewed the reasonableness of the assumptions in the MTFS, including the level of Government grant reductions expected, cost pressures and savings requirement.</p> <p>The MTFS contains assumptions about the future funding of the Council, national and local economic factors, the level of pay and non-pay inflation and a range of savings targets. Over the medium term, the Council expects the net budget requirement to reduce from £15.7 million in 2016/17 to £13.3 million in 2019/20 and its revenue support grant (which amounts to £2.7 million in 2015/16) will cease in 2019/20.</p> <p>The Council plans to balance its finances over the medium term by delivering savings of £3.8 million alongside projected growth in income from council tax. There are a number of key development and transformation projects in place under the Council's Sustainable Service Delivery Strategy to deliver savings from its Future Model, shared transformation costs, procurement, service efficiencies and increased income generation.</p>	<p>We were satisfied that the MTFS reflects known savings and cost pressures and that the key underlying assumptions regarding central government funding and income from taxation are not unreasonable.</p> <p>The Council understands the risks involved across its financial planning assumptions and that these will continue to require careful management. While there is a recognised funding gap in the MTFS, we were satisfied that the Council has appropriate arrangements to remain financially sustainable over the period of the MTFS.</p>

USE OF RESOURCES

Continued

TRANSFORMATION PROGRAMMES	RESPONSE	FINDINGS
<p>The Council has a number of major transformation and development programmes in place to either help facilitate these savings or create additional revenue streams in the medium term. These programmes include:</p> <ul style="list-style-type: none"> • Joint transformation programme with Lewes District Council to provide joint services • A £44 million project for the enhancement of the current Devonshire Park Complex. <p>We identified a risk of the MTFS failing to adequately take account of the investment costs and savings associated with these projects.</p>	<p><u>Joint transformation programme (JTP)</u></p> <p>We reviewed the arrangements in place for the Council to make informed decisions in relation to the programme. We also reviewed the JTP business case, including sensitivity analysis of future outcomes.</p> <p>The business case projects total savings of £2.8 million for the two councils, with an equivalent reduction of 79 full time equivalent posts across both councils. The Council's share of these planned savings is £1.2 million over the four year MTFS period.</p> <p>Total combined investment required specifically to deliver the JTP is £5.6 million, of which the Council's share is approximately £2.4 million. These costs will be largely met from the Council's earmarked reserves for strategic change and capital programme, which total £2.5 million at 31 March 2016.</p> <p><u>Devonshire Park Complex</u></p> <p>Costs totalling £2.2 million were incurred in 2015/16 on 'Devonshire Park Review Stage 1-4a' in preparation for the procurement in 2016/17. The Council's five year capital programme indicates that the investment is to be funded by a combination of capital receipts and borrowing.</p> <p>The Council has worked with external consultants to review the best future governance options for the project. A decision was made by Cabinet in September 2016 to adopt a wholly owned but organisationally discrete local authority managed operation, subject to necessary work on the detail of the governance structure being undertaken and proving satisfactory.</p>	<p>We were satisfied that the strategic objectives of the programme are in line with the Council's corporate vision. Adequate arrangements were in place to support decision making for the business case and appropriate governance processes have been established to oversee delivery of the project.</p> <p>The projected savings and investment from the programme have been adequately considered and factored into planning assumptions.</p> <p>The Devonshire Park complex project is still in its early stages. However given the scale of the project, it is important that robust governance and risk management arrangements are maintained as the project develops.</p>

EXERCISE OF STATUTORY POWERS

REPORT BY EXCEPTION

We have no matters to report by exception.

Use of statutory powers

We have not exercised our statutory powers and have no matters to report.

Audit certificate

We issued the audit certificate to close the audit for the year ended 31 March 2016 on 30 September 2016.

GRANT CLAIMS AND CERTIFICATION

CERTIFICATION WORK

Our review of grant claims and returns for 2015/16 is in progress and the results will be reported upon completion of this work.

Housing benefit subsidy claim

Public Sector Audit Appointments Ltd has a statutory duty to make arrangements for certification by the appointed auditor of the annual housing benefit subsidy claim.

During 2014/15, the Council replaced the Northgate benefit system with the Open revenues benefit system. Our testing found that this introduced a significant number of errors in the subsidy claim particularly, where benefits calculated in Open Revenues relied on the historic accuracy of data transferred from Northgate. This required a significant amount of additional work and testing to attempt to isolate the quantum of errors. For the errors that we identified in the transferred data, the Council made amendments which reduced subsidy claimed by £151,414.

We also identified a number of other issues relating to the system reconciliation of payments made, incorrect bedroom numbers used, ineligible service charge deductions, misclassified overpayments and incorrect earnings calculations. The estimated net subsidy impact of these errors, if amended, would be to reduce subsidy by £200,541.

The Council is working to address these issues in the current year.

Our work on the 2015/16 housing benefits subsidy claim is currently in progress and is expected to be completed ahead of the submission deadline of 30 November 2016.

Other claims and returns

A number of grant claims and returns that were previously included within the scope of the audit have since been removed, but Departments may still seek external assurance over the accuracy of the claim or return.

These assurance reviews are undertaken outside of our appointment by the Audit Commission or Public Sector Audit Appointments Ltd, and are covered by tripartite agreements between the Council, sponsoring Department and the auditor.

The Council has requested that we undertake a 'reasonable assurance' review, based on the instructions and guidance provided by the Department of Communities and Local Government (DCLG) for the 2015/16 pooling of housing capital receipts (deadline 30 November 2016). This work is in progress.

APPENDIX

Reports

We have issued the following reports since our previous Annual Audit Letter.

REPORT	DATE
Grant claims and certification work 2014/15	24 March 2016
Audit Plan 2015/16	17 February 2016
Draft audit completion report 2015/16	16 September 2016
Final audit completion report 2015/16	30 September 2016
Annual Audit Letter 2015/16	31 October 2016

Fees

We reported our original fee proposals in our Audit Plan. We have not had to amend our planned audit fees for 2015/16.

AUDIT AREA	FEES
Code audit	67,781
Certification of housing benefits subsidy	8,297
Fee for audit services	76,078
Audit related services:	
- Pooling of housing capital receipts	1,500
Fee for audit related services	1,500
Non audit related services:	
- BDO tax subscription services	2,500
Total fees	80,078

The matters raised in our report prepared in connection with the audit are those we believe should be brought to the attention of the organisation. They do not purport to be a complete record of all matters arising. No responsibility to any third party is accepted.

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