EASTBOURNE BOROUGH COUNCIL

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2018

31 August 2018

EXECUTIVE SUMMARY

PURPOSE OF THE LETTER

This annual audit letter summarises the key issues arising from the work that we have carried out at Eastbourne Borough Council for the year ended 31 March 2018.

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.

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 (NAO's) Code of Audit Practice (the Code). Under the Code, we are required to report on:

- Our opinion 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 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

AUDIT CONCLUSIONS

FINANCIAL STATEMENTS

We issued our unmodified opinion on the financial statements on 4 August 2018.

This was after the statutory deadline of 31 July 2018, primarily due to difficulties in the final stages of the audit in determining whether the Council needed to include its interest in a separate organisation, Greencoat House Limited, in its Group Accounts. This affected the timely completion of other areas of the audit.

We reported our detailed findings to the Audit and Governance Committee on 25 July 2018 and circulated an updated report on 3 August 2018.

Our audit identified two material misstatements in the primary financial statements, one relating to the netting-off of recharges within income and expenditure and the other relating to indexation on council dwellings. These were amended in the final financial statements and had no impact on the closing general fund balance.

We also reported an estimated audit difference of £401,000 in respect of the valuation of other land and buildings, which was not adjusted as it was not material.

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 4 August 2018.

The Council's Medium Term Financial Strategy (MTFS) reflects reductions in Government funding and indicates average budget gaps of £1.1 million per annum over the four year period to 2020/21. The Council currently has a number of projects in place to generate savings or create additional revenue streams to fill these gaps, including a continuing Joint Transformation Programme (JTP) with Lewes District Council for the provision of frontline services and the organisation of back office functions.

We are satisfied that the Council has appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.

FINANCIAL STATEMENTS

OPINION	We issued our unmodified opinion on the Council's financial statements on 4 August 2018.
	This means we consider the financial statements: • Give a true and fair view of the financial position and its income and expenditure for the year • Have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting 2017/18.

SCOPE OF THE AUDIT

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 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.

The materiality for the Council's single entity financial statements was set at £2.1 million and the Group financial statements at £2.2 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.

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 the direction of the efforts of the audit team.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Management override of controls	Under auditing standards, there is a presumed risk of management override of controls as management is in a unique position to manipulate accounting records to prepare fraudulent financial statements. We responded to this risk by: • Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements • Reviewing the accounting estimates for bias and evaluating whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud • Obtaining an understanding of the business rationale for any significant transactions that are outside the normal course of business for the Council or that otherwise appear to be unusual.	No issues were identified by our review of the appropriateness of journal entries or other adjustments made to the financial statements. Our work on accounting estimates did not identify any evidence of management bias. We did not identify any significant transactions that were outside the normal course of business or that otherwise appeared unusual.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Revenue and expenditure recognition	Under auditing standards there is a presumption that income recognition presents a fraud risk. We also considered the risk of misstatement through the manipulation of expenditure recognition. We responded to this risk by: • Testing an increased sample of fees and charges income to underlying documentation and confirming the existence and accuracy of transactions throughout the year • Testing a sample of fees and charges receipts either side of year end, to confirm that income had been recorded in the correct period and that all income that should have been recorded at year end had been • Testing a sample of expenditure either side of year end, to confirm that expenditure had been recorded in the correct period.	We did not identify any issues in our testing of revenue from fees and charges or receipts either side of year end. We did not identify any issues in our testing of expenditure either side of year end.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Valuation of land, buildings and investment property	Due to the significant value of the Council's property assets, and the high degree of estimation uncertainty, there is a significant risk over the valuation of land, buildings and investment properties where valuations are based on assumptions or where updated valuations have not been provided for a class of assets at the year end. We responded to this risk by: • Reviewing the instructions provided to the valuer and the valuer's skills and expertise in order to determine if we could rely on the management expert • Checking that the basis of valuation for assets valued in year was appropriate • Reviewing the reasonableness of assumptions used in the valuations against indices and price movements for classes of assets, and following up on valuation movements that appeared unusual against indices • Estimating the potential movement on classes of assets that were not revalued in year.	The Council engaged an external valuer to value its investment properties and carry out a year end desktop review on all other property categories. This included desktop valuations on £179.8 million of council dwellings based on open market value less a social housing discount, £57.5 million of specialised land and buildings held at depreciated replacement cost, and £18.6 million of other land and buildings based on existing use value. From our review of the instructions provided to the valuer and the valuer's reports, we were satisfied that we could rely on the management expert. We confirmed that the basis of valuation for assets valued in year was appropriate. From our review we were satisfied that property values, including properties not revalued in the year, were not materially misstated at year end, although our comparison to benchmarking indices indicated that other land and buildings valued on an existing use basis were stated at a value that was £401,000 below what we estimated as a reasonable range for the value.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Valuation of pension liability	There is a risk the membership data and cash flows provided to the actuary at 31 March may not be correct, or the valuation uses inappropriate assumptions to value the liability. This is a significant risk due to the higher estimation uncertainty arising from the range of assumptions available to value the pension liability. We responded to this risk by: • Agreeing the disclosures to information provided by the actuary • Reviewing the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data • Obtaining assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary • Checking whether any significant changes in membership data had been communicated to the actuary.	The majority of actuarial assumptions remained consistent between the years, other than an increase in the discount rate that reduced the liability. However, the net pension liability increased overall by £2.18 million compared to the previous year, due to the transfer in of Eastbourne Homes Limited staff who TUPE'd over to the Council during the year. Our review of the initial actuarial report found that it incorrectly excluded this transfer. The Council obtained a revised report from the actuary that included the bulk transfer-in and management amended the financial statements for the revised valuation. Our review of assumptions used to estimate the value of the pension liability concluded that they were reasonable. We used the PwC consulting actuary report for reviewing the methodology of the actuary and assessing the reasonableness of the assumptions. We obtained assurance from the pension fund auditor over the controls at the administering authority for providing accurate information on scheme members for the 2016 triennial review and information for 2017/18.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Group Accounts	There is a risk that income, expenditure, assets and liabilities in the Group Accounts may not be complete if the Council does not account for its share of material transactions in Greencoat House Limited (the holding company for Wealden and Eastbourne Lifeline Limited, Welbeing), and Aspiration Homes Limited. We responded to this risk by: • Reviewing the financial statements and management accounts of Welbeing and Aspiration Homes Limited and assessing whether management had fully considered the need to include its interest in these entities in its Group Accounts • Determining whether the Council had appropriately accounted for its interest in these entities, where material, taking account of the nature and underlying substance of the arrangements.	The Council previously held 49% of the voting rights and 21% of the non-voting rights in Greencoat House Limited. This was considered to be an associate, as the Council had significant influence but not control over these organisations. Historically the Council has not included them in its Group Accounts, as their transactions have not been material. During 2017/18, the Council purchased additional 'B' shares in Greencoat House Limited, which were subsequently converted into 'A' shares by Board resolution. This increased its shareholding to 49% of the voting rights and 26% of non-voting rights. However, as the Council's voting rights remained capped at 49%, it did not obtain control of the company through this acquisition. The management accounts of Welbeing indicate that the company had retained earnings of £2.086 million at 31 March 2018. The holding company had negligible retained earnings. Therefore, based on our materiality level of £2.2 million for the Group Accounts, we were satisfied that the Council's 75% interest in the two entities was not material at year end and they did not need to be included in the Group Accounts. Review of the financial statements of Aspiration Homes Limited indicated that the company did not have any material activity during 2017/18 and therefore it was acceptable that the Council did not consolidate its 50% interest in this company in its Group Accounts.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Recharges between the Council and Lewes District Council	Under the JTP with Lewes District Council, the vast majority of Lewes' employees transferred onto the Council's payroll during 2016/17 whilst Legal Services remain within Lewes. There are recharging arrangements in place between the councils. Given that this is the first full year of these recharge arrangements, there is a risk over the accuracy of expenditure in the Comprehensive Income and Expenditure Statement (CIES). There is also a risk that redundancies resulting from the JTP may not be appropriately accounted for and disclosed in line with the Code of Practice on Local Authority Accounting 2017/18. We responded to this risk by: • Reviewing the reasonableness and accuracy of the recharge arrangements in place between the councils, seeking assurance that the Council's share of the costs is in line with approved recharge arrangements • Reviewing the completeness and accuracy of redundancy accruals and provisions and exit package disclosures.	We confirmed that there are appropriate arrangements in place to keep track of amounts that need to be recharged on monthly basis. For the service lines that were set us as shared service arrangements in phase one of the JTP, there are set percentages in place for the amounts recharged, which are between 40% and 50% per service. As further shared services and greater integration between Council staff developed during the year, the Council moved away from recharging Lewes District Council 100% of the hosted payroll cost and is now allocating payroll and some non-payroll costs between the councils on a shared service basis. Our testing confirmed that costs are split between 40% and 50%, dependent on the service line. The Deputy Chief Executive has delegated authority from both councils to determine the appropriate split of JTP costs and benefits. Our audit noted that £15 million of costs recharged to Lewes District Council were recorded on a gross basis within the CIES. However, as the Council is acting in an agent capacity in these joint operations, sharing the risks and rewards with Lewes District Council, it is more appropriate for each council to recognise its share of income and expenditure on a net basis. As a result, the financial statements were amended to net recharge income off against expenditure. Our audit of exit packages did not identify any issues.

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 4 August 2018.
	This means we consider that the Council has proper arrangements to: • Ensure it took properly informed decisions • Deploy resources to achieve planned and sustainable outcomes for taxpayers and local people.

SCOPE OF THE AUDIT

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources.

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 our opinion on the financial statements, reports from the Council including internal audit, information disclosed or available to support the annual governance statement, 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 the direction of the efforts of the audit team.

USE OF RESOURCES

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Financial sustainability	The update to the MTFS to 2020/21 forecasts further reductions in Government core grant funding and annual inflationary and pay award pressures. The MTFS indicates budget gaps of £1.350 million in 2018/19, £775,000 in 2019/20, £1.478 million in 2020/21 and £765,000 in 2021/22. This means an average level of required savings of £1.1 million per annum over the four year period. The Council currently has a number of major development / transformational programmes in place to facilitate savings or create additional revenue streams in the medium term, to close the budget gaps. We identified a risk that the MTFS does not adequately take account of the investment costs and savings associated with these projects, and that the Council does not have appropriate arrangements to monitor progress in delivering benefits from these projects against the MTFS. We responded to this risk by: • Assessing the effectiveness of the Council's arrangements for ensuring sustainable finances by reviewing current year outcomes and the Council's reserves position • Reviewing the assumptions used in the MTFS for investment costs and savings associated with its major development / transformational programmes • Reviewing the Council's arrangements for monitoring the progress of these programmes against budgeted savings targets.	The Council has a track record of delivering underspends in the General Fund. In 2017/18, the Council originally budgeted for a decrease in the general fund of £1.143 million, before transfers from earmarked reserves. There were variances in the year but the final position against the revised budget was an underspend of £434,000. The general fund balance at 31 March 2018 is £3.033 million, an increase of £373,000 from the prior year. General fund earmarked reserves decreased by £651,000, to £5.305 million, which was largely due to the use of capital reserves set aside for financing one-off capital schemes. The Council achieved £803,000 of its budgeted savings target of £981,000 for the year. A key component of this is savings from the JTP with Lewes District Council, although this under-achieved by £175,000 against the budget. The shortfall is being made up during 2018/19. The required savings for 2018/19 have been identified and relate largely to planned new income streams, the JTP and procurement savings. Other development programmes currently in place include the enhancement of the Devonshire Park complex, redevelopment of the Sovereign Centre Leisure facilities, joint housing investment partnership and joint venture for energy and sustainability. We are satisfied that the MTFS takes account of the investment costs associated with the Council's major transformational and development projects. When these schemes are further established, management should be in a better place to forecast all of the associated savings and revenue contributions going forward.

APPENDIX

REPORTS ISSUED

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

REPORT	DATE
2017/18 audit plan	February 2018
2017/18 audit completion report	July 2018

FEES

AUDIT AREA	FINAL FEES £	PLANNED FEES £
Audit - PSAA scale fee	67,781	67,781
Audit - additional fee	TBC*	-
Housing benefits subsidy certification fee	11,310	11,310
Total audit and certification fees	**TBC**	**79,091**
Fees for audit related services:		
Pooling of housing capital receipts return	1,500	1,500
Total fees	**TBC**	**80,591**

*We are in the process of discussing additional audit fees with management to cover overruns on the final accounts audit. Any additional fee would also be subject to approval by Public Sector Audit Appointments Limited.

We have not provided any other non-audit services.

FOR MORE INFORMATION:

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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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