Report No. 49/16

LEWES DISTRICT COUNCIL

PLANNING REPORT TO THE AUDIT AND STANDARDS COMMITTEE

Audit for the year ending 31 March 2016

24 February 2016

BDO

CONTENTS

INTRODUCTION

PURPOSE AND USE OF OUR REPORT

The purpose of this report is to highlight and explain the key issues which we believe to be relevant to the audit of the financial statements and use of resources of Lewes District Council (the Council) for the year ending 31 March 2016. It forms a key part of our communication strategy with you, a strategy which is designed to promote effective two-way communication throughout the audit process. Planning is an iterative process and our plans, reflected in this report, will be reviewed and updated as our audit progresses.

This report has been prepared solely for the use of the Audit and Standards Committee.

In preparing this report, we do not accept or assume responsibility for any other purpose, or to any other person to whom it is shown or into whose hands it may come, except when expressly agreed by our prior written consent. If others choose to rely on the contents of this report, they do so entirely at their own risk.

YOUR BDO TEAM

Name	Contact details	Key responsibilities
JANINE COMBRINCK Engagement Lead	Tel: 020 7893 2631 janine.combrinck@bdo.co.uk	Oversee the audit and sign the audit report
JODY ETHERINGTON Project Manager	Tel: 01473 320790 jody.etherington@bdo.co.uk	Management of the audit
TAWANDA MUTENGA Senior	Tel: 01473 320711 tawanda.mutenga@bdo.co.uk	Day to day supervision of the on-site audit

Janine Combrinck is the engagement lead and has the primary responsibility to ensure that the appropriate audit opinion is given on the financial statements and use of resources.

In meeting this responsibility, she will ensure that the audit has resulted in obtaining sufficient and appropriate evidence to provide reasonable, but not absolute, assurance that:

- the financial statements are free from material misstatement, whether due to fraud or error
- the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

She is also responsible for the overall quality of the engagement.

OUR CLIENT SERVICE COMMITMENT TO YOU

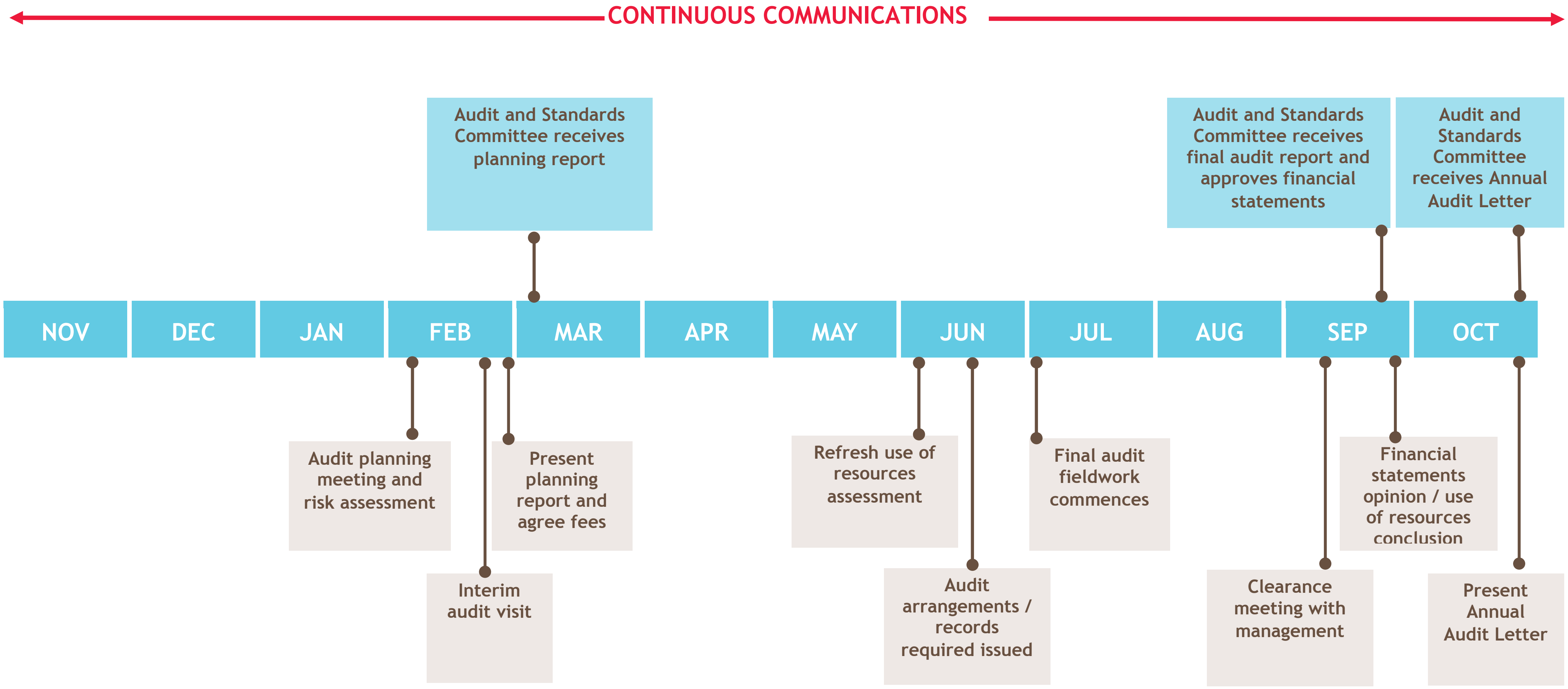
CLIENT SERVICE EXPECTATIONS

1	2	3	4	5	6	7	8
High quality audit service at a reasonable cost.	A quality team, with relevant expertise.	Clear communication.	Concentrating our work on areas of higher risk.	Avoiding surprises through timely reporting of issues.	Consulting with management to resolve matters early.	Meeting deadlines.	Identifying shortcomings in controls and processes.

ENGAGEMENT TIMETABLE

TIMETABLE

The timeline below identifies the key dates and anticipated meetings for the production and approval of the audited financial statements and completion of the use of resources audit.



AUDIT SCOPE AND OBJECTIVES

SCOPE AND OBJECTIVES

Our audit scope covers the audit in accordance with the National Audit Office (NAO) Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the NAO.

To form an opinion on whether:

FINANCIAL STATEMENTS		OTHER INFORMATION	WGA CONSOLIDATION	USE OF RESOURCES
1 The financial statements give a true and fair view of the financial position of the authority and its expenditure and income for the period in question.	2 The financial statements have been prepared properly in accordance with the relevant accounting and reporting framework as set out in legislation, applicable accounting standards or other direction.	3 Other information published together with the audited financial statements is consistent with the financial statements (including the governance statement).	4 The return required to facilitate the preparation of WGA consolidated accounts is consistent with the audited financial statements.	5 The authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

ADDITIONAL POWERS AND DUTIES	
6 To consider the issue of a report in the public interest, where necessary. To make a written recommendation to the authority, where necessary.	7 To allow electors to raise questions about the accounts and consider objections. To apply to the court for a declaration that an item of account is contrary to law, where necessary. To consider whether to issue an advisory notice or to make an application for judicial review, where necessary.

MATERIALITY

COUNCIL MATERIALITY

	MATERIALITY	CLEARLY TRIVIAL THRESHOLD
Council	£1,630,000	£32,000

Please see Appendix I for detailed definitions of materiality and triviality.

Planning materiality for the Council has been based on 2% of the prior year gross expenditure. This will be revisited when the draft financial statements are received for audit.

The clearly trivial amount is based on 2% of the materiality level.

OVERALL AUDIT STRATEGY

We will perform a risk based audit on the Council's financial statements and use of resources

This enables us to focus our work on key audit areas.

Our starting point is to document our understanding of the Council's business and the specific risks it faces. We discussed the changes to the business and management's own view of potential audit risk during our planning meetings in order to gain an understanding of the Council's activities and to determine which risks impact on our audit. We will continue to update this assessment throughout the audit.

For the financial statements audit, we also confirm our understanding of the accounting systems in order to ensure their adequacy as a basis for the preparation of the financial statements and that proper accounting records have been maintained.

For the use of resources audit, we consider the significance of business and operational risks insofar as they relate to 'proper arrangements', including risks at both sector and authority-specific level, and draw on relevant cost and performance information as appropriate.

We then carry out our audit procedures in response to risks.

Risks and planned audit responses

For the financial statements audit, under International Standard on Auditing 315 "Identifying and assessing the risks of material misstatement through understanding the entity and its environment", we are required to consider significant risks that require special audit attention.

In assessing a risk as significant, we exclude the effects of identified controls related to the risk. The ISA requires us at least to consider:

- Whether the risk is a risk of fraud
- Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention
- The complexity of transactions
- Whether the risk involves significant transactions with related parties
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty
- Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

For the use of resources audit, the NAO has provided information on potential significant risks such as:

- Organisational change and transformation
- Significant funding gaps in financial planning
- Legislative or policy changes
- Repeated financial difficulties or persistently poor performance
- Information from other inspectorates and review agencies suggesting governance issues or poor service performance.

We consider the relevance of these risks to the Council in forming our risk assessment and audit strategy.

Internal audit

We will ensure that we maximise the benefit of the overall audit effort carried out by internal audit and ourselves, whilst retaining the necessary independence of view.

We understand that internal audit reviews have been undertaken across a range of accounting systems and governance subjects. We will consider these reports as part of our audit planning and consider whether to place any reliance on internal audit work as evidence of the soundness of the control environment.

KEY AUDIT RISKS AND OTHER MATTERS

Key: Significant risk   Normal risk   Other issue

AUDIT RISK AREAS - FINANCIAL STATEMENTS			
RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
Management override	The primary responsibility for the detection of fraud rests with management. Their role in the detection of fraud is an extension of their role in preventing fraudulent activity. They are responsible for establishing a sound system of internal control designed to support the achievement of departmental policies, aims and objectives and to manage the risks facing the organisation; this includes the risk of fraud. Under International Standard on Auditing (UK and Ireland) 240 “The Auditor’s responsibility to consider fraud in an audit of financial statements”, there is a presumed significant risk of management override of the system of internal controls.	Our audit is designed to provide reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or error. We are not responsible for preventing fraud or corruption, although our audit may serve to act as a deterrent. We consider the manipulation of financial results through the use of journals and management estimates as a significant fraud risk. In every organisation, management may be in a position to override routine day to day financial controls. Accordingly, our audit has been designed to consider this risk and adapt procedures accordingly.	Not applicable.
Revenue recognition	Under International Standard on Auditing 240 there is a presumption that income recognition presents a fraud risk. For local authorities, the risks can be identified as affecting the completeness, accuracy and existence of income. We consider there to be a significant risk over the completeness, existence and accuracy of income in relation to fees and charges recorded in the Comprehensive Income & Expenditure Statement (CIES).	We will carry out audit procedures to gain an understanding of the Council’s internal control environment for fees and charges, including how this operates to prevent loss of income, and ensure that income is recognised in the correct accounting period. We will carry out focussed substantive testing on a sample of income received and debtor accruals to ensure that accounting policies have been correctly applied in determining the point of recognition of income. We will also use analytical procedures, drawing upon our understanding of the Council’s revenue streams, to gain assurance over the completeness of income.	Not applicable.

KEY AUDIT RISKS AND OTHER MATTERS
Continued

AUDIT RISK AREAS – FINANCIAL STATEMENTS			
RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
Property, plant and equipment (PPE) valuations	The Code requires management to carry out a full valuation of its land and buildings on a periodic basis (at least every 5 years). In the intervening years, management is required to assess whether there has been a material change in the value of its assets which should be accounted for. This year, the Council has appointed an external valuer to carry out a full five-yearly valuation of Council dwellings. Other land and buildings were last revalued at 1 April 2014. In addition, the adoption of IFRS 13 “Fair Value Measurement” in 2015/16 now requires surplus assets to be valued at fair value based on their ‘highest and best’ use, where there are no restrictions to the market, which may differ from the ‘existing use’ values previously used. Our discussions with management have indicated that the Council holds a number of assets which may fall into this category, and which will need to be revalued at fair value. Due to the significant value of land and buildings, and the high degree of estimation uncertainty, we consider there to be a significant risk of material misstatement in respect of the valuation of PPE. We also note that during the prior year’s audit we identified a significant level of misstatement in the draft financial statements in respect of how PPE revaluations had been accounted for, which resulted in material adjustments to the financial statements. As such, we also consider there to be a significant risk of material misstatement in respect of the	For formal valuations carried out in the year, we will review the instructions provided to the valuer and review the valuer’s skills and expertise in order to determine if we can rely on the management expert used. We will check whether the basis of valuation for assets valued in year is appropriate based on their usage. We will also consider whether there have been any material movements in the value of non-current assets between valuation dates and year end, which would need to need to be accounted for. We will review the Council’s listing of non-current assets at year-end, to check whether all surplus assets have been revalued at fair value. We will also review a sample of other assets to consider whether they are correctly classified within the PPE note. We will agree all significant revaluation movements to supporting documentation, and check that these movements have been correctly accounted for and presented within the PPE note, CIES, and reserves.	We will review indices and price movements for classes of assets provided by Gerald Eve LLP to assess the reasonableness of the Council’s valuations.

	accuracy of presentation of PPE and related revaluation and impairment transactions posted to the CIES and reserves.

KEY AUDIT RISKS AND OTHER MATTERS
Continued

AUDIT RISK AREAS - FINANCIAL STATEMENTS			
RISK	**DESCRIPTION**	**PLANNED AUDIT RESPONSE**	**EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE**
Pension liability assumptions	The net pension liability comprises the Council's share of the market value of assets held in the East Sussex County Council Pension Fund and the estimated future liability to pay pensions. An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate is required to be based on the most up to date membership data held by the pension fund and have regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation when calculating the liability. There is a risk the valuation is not based on accurate membership data or uses inappropriate assumptions to value the liability.	We will obtain assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary. We will review the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data. We will agree the disclosure to the information provided by the actuary.	We will agree the disclosures to the report received from the Council's actuary. We will use the PwC consulting actuary report commissioned by Public Sector Audit Appointments Limited (PSAA) for the review of the methodology of the actuary and reasonableness of the assumptions used.
Senior officer remuneration note	We note that there have been a number of changes at senior management level within the Council during 2015/16. This introduces an increased risk of error in respect of the senior officer remuneration note, in terms of ensuring that all senior officers are included for the correct periods, and that where posts are shared with another authority, the appropriate Code disclosure requirements are complied with. The Council will also need to ensure that any exit packages are appropriately disclosed.	We will review the senior officer remuneration note against supporting documentation such as contracts and payslips. We will check that all Code requirements have been complied with through the completion of a disclosure checklist. We will gain assurance over the completeness of exit package disclosures through discussion with management, review of Cabinet and Council minutes, and review of relevant ledger codes.	Not applicable.

KEY AUDIT RISKS AND OTHER MATTERS
Continued

AUDIT RISK AREAS - FINANCIAL STATEMENTS			
RISK	**DESCRIPTION**	**PLANNED AUDIT RESPONSE**	**EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE**
Financial instrument disclosures	During the prior year audit, we identified a number of errors within the draft financial instruments notes, including omissions within the fair value disclosure tables, an incorrect methodology being applied to the presentation of maturity analysis figures, and the incorrect treatment of debtor impairments. In addition, no sensitivity analysis was provided in the 'Market Risk' section of the note.	We will review the disclosures in the draft Statement of Accounts against supporting working papers, and other parts of the financial statements. We will complete a disclosure checklist to gain assurance over the completeness and presentation of the financial instrument disclosures.	We will refer to any financial instrument valuations provided by the Council's investment managers or advisers. Where relevant, we will carry out additional procedures to confirm the competence, independence and objectivity of the management experts employed by the Council.
Narrative reporting	The Council will be required to produce a 'Narrative Report' replacing the Explanatory Foreword in the financial statements. The Narrative Report includes additional information not previously included in the Explanatory Foreword.	We will review the Narrative Report to ensure that it complies with current guidance and regulations.	Not applicable.
Fraud and error	We are required to discuss with you the possibility of material misstatement, due to fraud or error, and reassess this throughout the audit. We are informed by management that there have not been any cases of material fraud or error, to their knowledge.	We will continue to consider this throughout the audit process and discuss with management.	Not applicable.

KEY AUDIT RISKS AND OTHER MATTERS
Continued

AUDIT RISK AREAS – USE OF RESOURCES			
RISK	**DESCRIPTION**	**PLANNED AUDIT RESPONSE**	**EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE**
Sustainable finances	The Council's Medium Term Financial Strategy (MTFS) was updated in February 2016 to cover the four year period to 2019/20. This indicates that the Council is required to make an average level of savings of £705,000 per annum over the four year period. The Council has identified savings which exceed this target by £365,000, although delivery is likely to be challenging and will require further difficult decisions around service provision and alternative delivery models. The Council is currently in the process of undergoing a major transformation programme to help facilitate these savings through closer joint working with Eastbourne Borough Council, both in the provision of frontline services and the organisation of back office functions. Other savings identified by the Council include a reduction in service fees paid to Wave Leisure Trust; the phasing out of Local Council Tax Support grants to town and parish councils; income generation from solar, waste and recycling; and regeneration schemes. There is a risk that the MTFS does not adequately take account of the investment costs and savings associated with these projects.	We will review the reasonableness of the assumptions in the MTFS, including the level of Government grant reductions expected, cost pressures, and investment and savings associated with the transformation programme. We will review the arrangements in place for the Council to make informed decision making in relation to its transformation programme. In particular, we will consider how the Council understands and uses reliable financial information to make decisions and how it supports the delivery of strategic priorities, as well as reviewing the governance structures and processes in making decisions.	Business case, including sensitivity analysis of future outcomes, for the Council's transformation programme.

KEY AUDIT RISKS AND OTHER MATTERS
Continued

AUDIT RISK AREAS – USE OF RESOURCES			
RISK	**DESCRIPTION**	**PLANNED AUDIT RESPONSE**	**EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE**
New homes project	In July 2015, the Council signed a Conditional Sale Agreement and Profit Share and Project Management Agreement with a private sector consortium, in respect of a project to raise funds to allow the Council to build a number of new Council homes across the district, and at the same time to bring regenerative benefits to a number of sites. This was meant to have been a significant project involving the sale of a number of the Council's surplus land assets, and substantial investment from both the Council and the consortium. In February 2016 a decision was taken by Cabinet to terminate this agreement as a result of the non-satisfaction of title and ground conditions in respect of key sites within the project. Given the scale of the project, there is a risk to our use of resources opinion if due process was not followed by the Council in entering into the contract and terminating the contract.	We will review the governance and decision making processes followed by the Council in entering into the Conditional Sale Agreement, and subsequently terminating the agreement, to determine whether the Council's own internal processes were followed and whether these were sufficient to ensure that appropriately informed decisions were made. This will involve a review of relevant documents and Cabinet minutes, and discussions with management and officers involved in the project.	Not applicable.

INDEPENDENCE

INDEPENDENCE

Under Auditing and Ethical Standards, we are required as auditors to confirm our independence to 'those charged with governance'. In our opinion, and as confirmed by you, we consider that for these purposes it is appropriate to designate the Audit and Standards Committee as those charged with governance.

Our internal procedures are designed to ensure that all partners and professional staff are aware of relationships that may be considered to have a bearing on our objectivity and independence as auditors. The principal statements of policies are set out in our firm-wide guidance. In addition, we have embedded the requirements of the Standards in our methodologies, tools and internal training programmes. The procedures require that engagement leads are made aware of any matters which may reasonably be thought to bear on the firm's independence and the objectivity of the engagement lead and the audit staff. This document considers such matters in the context of our audit for the period ending 31 March 2016.

We are not planning to provide any non audit services.

We have not identified any other potential threats to our independence as auditors.

We confirm that the firm complies with the Financial Reporting Council's Ethical Standards for Auditors and, in our professional judgement, is independent and objective within the meaning of those Standards.

In our professional judgement the policies and safeguards in place ensure that we are independent within the meaning of all regulatory and professional requirements and that the objectivity of the audit engagement lead and audit staff is not impaired. These policies include engagement lead and manager rotation. The table in appendix II sets out the length of involvement of key members of the audit team and the planned year of rotation.

Should you have any comments or queries regarding this confirmation we would welcome their discussion in more detail.

FEES

FEES SUMMARY

Our proposed fees, excluding VAT, for the year ending 31 March 2016 are:

	£
Code fee - audit of financial statements	46,418
Code fee - certification of housing benefit subsidy claim	14,960
Fees for audit related services - review of the pooling of housing capital receipts return	1,500
TOTAL FEES	62,878

Code audit fee invoices for the audit of financial statements will be raised as set out below, following which our firm's standard terms of business state that full payment is due within 14 days of receipt of invoice:

- Instalment 1: £11,604.50 in June 2015
- Instalment 2: £11,604.50 in September 2015
- Instalment 3: £11,604.50 in December 2015
- Instalment 4: £11,604.50 in March 2016

Fee invoices for other audit related services will be raised as the work is completed.

Our fee is based on the following assumptions

The complete draft financial statements and supporting work papers will be prepared to a standard suitable for audit. All balances will be reconciled to underlying accounting records.

Key dates will be met, including receipt of draft accounts and working papers prior to commencement of the final audit fieldwork.

We will receive only one draft of the financial statements prior to receiving the final versions for signing.

Within reason, personnel we require to hold discussions with will be available during the period of our on-site work (we will set up meetings with key staff in advance).

APPENDIX I: MATERIALITY

CONCEPT AND DEFINITION

- The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to monetary misstatements but also to disclosure requirements and adherence to appropriate accounting principles and statutory requirements.
- We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. For planning, we consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. 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.
- Materiality therefore has qualitative as well as quantitative aspects and an item may be considered material, irrespective of its size, if it has an impact on (for example):
  - Narrative disclosure e.g. accounting policies, going concern
  - Instances when greater precision is required (e.g. senior management remuneration disclosures).
- International Standards on Auditing (UK & Ireland) also allow the auditor to set a lower level of materiality for particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

CALCULATION AND DETERMINATION

- We have determined materiality based on professional judgement in the context of our knowledge of the Council, including consideration of factors such as sector developments, financial stability and reporting requirements for the financial statements.
- We determine materiality in order to:
  - Assist in establishing the scope of our audit engagement and audit tests
  - Calculate sample sizes
  - Assist in evaluating the effect of known and likely misstatements on the financial statements.

APPENDIX I: MATERIALITY
Continued

REASSESSMENT OF MATERIALITY

- We will reconsider materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality if we had been aware.
- Further, when we have performed all our tests and are ready to evaluate the results of those tests (including any misstatements we detected) we will reconsider whether materiality combined with the nature, timing and extent of our auditing procedures, provided a sufficient audit scope. If we conclude that our audit scope was sufficient, we will use materiality to evaluate whether uncorrected misstatements (individually or in aggregate) are material.
- You should be aware that any misstatements that we identify during our audit, both corrected and uncorrected errors, might result in additional audit procedures being necessary.

UNADJUSTED ERRORS

- In accordance with auditing standards, we will communicate to the Audit and Standards Committee all uncorrected misstatements identified during our audit, other than those which we believe are ‘clearly trivial’.
- Clearly trivial is defined as matters which will be of a wholly different (smaller) order of magnitude than the materiality thresholds used in the audit, and will be matters that are clearly inconsequential, whether taken individually or in aggregate.
- We will obtain written representations from the Audit and Standards Committee confirming that in their opinion these uncorrected misstatements are immaterial, both individually and in aggregate and that, in the context of the financial statements taken as a whole, no adjustments are required.
- There are a number of areas where we would strongly recommend/request any misstatements identified during the audit process being adjusted. These include:
  - Clear cut errors whose correction would cause non-compliance with statutory requirements, management remuneration, other contractual obligations or governmental regulations that we consider are significant.
  - Other misstatements that we believe are material or clearly wrong.

APPENDIX II: INDEPENDENCE

INDEPENDENCE - ENGAGEMENT TEAM ROTATION		
SENIOR TEAM MEMBERS	**NUMBER OF YEARS INVOLVED**	**ROTATION TO TAKE PLACE IN YEAR ENDING**
JANINE COMBRINCK - Engagement lead	1 year as engagement lead and 2 years as project manager	31 March 2018
JODY ETHERINGTON - Project manager	2 years as project manager	31 March 2024