LEWES DISTRICT 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 on 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.

BDO LLP
27 October 2016

Audit conclusions

FINANCIAL STATEMENTS

We issued an unqualified true and fair opinion on the financial statements on 7 October 2016. We were unable to meet the national deadline of 30 September 2016 due to misstatements in the Cash Flow Statement and supporting notes and outstanding working papers relating to non-current asset revaluation movements. These issues were fully resolved before we issued our audit opinion.

We reported our detailed findings to the Audit and Standards Committee on 26 September 2016, and issued an updated report to the Committee on 6 October 2016 following resolution of the above issues.

We identified no significant deficiencies in internal controls. We did, however, report on areas where improvements in controls could be made including the related party transaction declaration process, documentation around council tax discounts, and access arrangements for key IT systems.

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 7 October 2016.

We are satisfied that the Council has adequate arrangements in place for budget setting and budget monitoring, and the Council has identified sufficient savings over the next four years to balance its budget. Many of these savings will arise from the ongoing Joint Transformation Programme with Eastbourne Borough Council, and we are satisfied that effective governance arrangements are in place to oversee delivery of this project.

We reviewed governance arrangements in place in respect of the Council's New Homes Project, and have made a number of recommendations for improvement that should be applied to future projects.

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 2015/16 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 7 October 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 has focused on testing the completeness, existence and accuracy of fees and charges to check that income has been recorded in the correct period and that all income that should have been recorded has been recorded. This included testing an increased sample of income received and debtor accruals. We also refreshed our 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.	No issues were identified by our testing of revenue from fees and charges.

FINANCIAL STATEMENTS
Continued

VALUATION OF LAND AND BUILDINGS	RESPONSE	FINDINGS
The valuation of operational land and buildings included in Property, Plant and Equipment (PPE) is estimated based on market values for existing use or depreciated replacement cost (DRC). In addition, the Code of Practice on Local Authority Accounting 2015/16 ('the Code') introduced a change in the basis of valuation of surplus assets and investment properties under International Financial Reporting Standard (IFRS) 13 to a 'highest and best use' valuation. Given the significant amounts involved, there is an inherent risk that the basis of valuation for these assets may not be appropriate or may not be supported by available valuation data, and this risk is further increased where requirements have changed. During 2015/16 the Council appointed an external valuer to carry out a full five-yearly valuation of its council dwellings, and also commissioned a valuation of all surplus assets and investment properties using the new approach. The result of the revaluation was a net upwards movement of £40.7 million on Council dwellings, a net upwards £3.3 million on other PPE, and a net downwards movement of £0.1 million on investment properties.	We reviewed the valuations provided and the valuation methodology applied, and confirmed that the basis of valuation for assets valued in year was appropriate based on the Code requirements. We compared the valuations to expected movements using available market information, and also reviewed assets not revalued in year for evidence of material movements which would need to be accounted for. Finally, we agreed all significant revaluation movements to supporting documentation, and checked that these movements were correctly accounted for and presented within the financial statements.	We concluded that the basis of the valuations in year were appropriate. We noted that the increase in valuation of council dwellings of 23.5% was significantly higher than our expectation based upon observable data such as house price indices. We discussed this with the external valuer, and confirmed that the reason for this increase was that the prior year valuation was understated, having been based upon an annual desktop refresh of a 2010 valuation. Under the circumstances we were content that the Council had correctly treated the change in valuation as a change in accounting estimate within its financial statements. We agreed with the Council's conclusion that there was no material movement in the valuation of PPE not revalued during the year. We identified a small number of minor calculation errors made in calculating and posting revaluation movements to the ledger. These were not material, and were mostly corrected in the final financial statements - the remaining error is included within Audit Differences on page 6 of this report.

FINANCIAL STATEMENTS
Continued

PENSION LIABILITY	RESPONSE	FINDINGS
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. 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. At 31 March 2016 the net pension liability decreased by £8.6 million, mainly as a result of a lower discount rate applied to the liabilities by the actuary.	We reviewed the reasonableness of the assumptions applied by comparing these to the expected ranges provided by an independent consulting actuary. The key changes to the financial assumptions relate to: • A reduction in the pension increase rate from 2.4% to 2.2% • A reduction in the salary increase rate from 4.3% to 4.2% • An increase in the discount rate from 3.2% to 3.5% (to place a current value on the future liabilities through the use of a market yield of corporate bonds).	We were satisfied that the assumptions used were not unreasonable or outside of the expected ranges.
ALLOWANCE FOR NON-COLLECTION OF RECEIVABLES	**RESPONSE**	**FINDINGS**
The Council estimates the proportion of debt due that it may not be able to recover and provides against this debt. The largest allowances relate to housing benefit overpayments and housing rent arrears. The allowance for housing benefit overpayments increased by £278,000 to £681,000, against a total overpayments balance of £2.0 million. The allowance for housing rent arrears increased by £165,000 to £494,000, against a total arrears balance of £662,000.	We reviewed the methodology and assumptions used by the Council is estimating its allowance of non-collection of receivables. For housing benefits overpayments, we were satisfied that the impairment allowance was based on the age of the debts and that the underlying assumptions were reasonable, although we found a minor error in the calculation resulting in an understatement of the allowance by £74,000. For housing rent arrears, we were satisfied that the impairment allowance was based on the size of the debt and the nature of the debtor and that the underlying assumptions were reasonable.	Overall we concluded that the impairment allowances for receivables were reasonable. We identified one minor calculation error which is included within Audit Differences on page 6 of this report.

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 £1.4 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 Standards Committee that we would report all individual audit differences in excess of £28,000.

Audit differences

There were no differences that were corrected in the financial statements that affected the reported surplus for the year, although a number of amendments to classifications and disclosures were made in the final financial statements. Of these, the items considered material were as follows:

- Material misstatements in the Cash Flow Statement and associated notes relating mainly to the treatment of interest received and paid, capital grants received and collection fund balances
- Reclassification of £2 million of Treasury notes from cash and cash equivalents to short-term investments.

Our audit also found 2 audit differences not corrected in the final financial statements that impact on the reported surplus:

- Revaluation increases of £130,000 which were posted to the revaluation reserve instead of the Comprehensive Income and Expenditure Statement.
- A £74,000 understatement of the allowance for non-collection of receivables as a result of errors in the aged debtor analysis.

Correcting for these misstatements would have resulted in the Council reporting a £56,000 higher surplus for the year.

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

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 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. However, a number of areas for improvement were identified which we discussed with management, covering:

- Related party transaction declarations
- Documentation surrounding council tax discounts
- Administrator access to IT systems, and password controls within the Icon receipting system.

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 WGA Assurance Statement to the WGA audit team with the total values for assets, liabilities, income and expenditure. We submitted this on 7 October 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 7 October 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, information available from the risk registers and supporting arrangements, and other information brought to our attention during the course of the audit.

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
The Council's Medium Term Financial Strategy (MTFS) was last refreshed in February 2016, and covers the period up to 2019/20. Over this period, the Council expects the net budget requirement to reduce from £13.1 million to £11.1 million, and that by 2018/19 its revenue support grant will cease. The Council plans to balance its finances over the four year period by delivering savings of £2.821m, which will sit alongside projected growth in income from council tax. Savings schemes totalling £3.186 million have already been identified. However, there remains a risk that the Council does not have appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.	We reviewed the Council's plans to close the budget gaps though savings, efficiencies and income growth. The Council had budgeted to spend £11.3 million on General Fund services in in 2015/16. The actual cost of services (before technical accounting adjustments) was lower than budget, at £10.7 million. This meant that the Council was able to increase its general fund balance by £0.5 million (to £2.1 million), and it also increased its earmarked general fund reserves from £10.3 million to £10.7 million at 31 March 2016. The Council achieved £570,000 against its planned £561,000 savings target in 2015/16, which was largely due to the second phase of its organisational development plans and vacancy savings.	The Council understands the risks involved across its financial planning assumptions and that these will continue to require careful management. We are satisfied that the MTFS reflects known savings and cost pressures and that the key underlying assumptions regarding reductions in central government funding and income from taxation are not unreasonable. We are satisfied that the Council has adequate arrangements in place for budget setting and budget monitoring. The Council has a track record of delivering underspends in the general fund and taking action to minimise the impact of overspends, and the balances in the General Fund and earmarked reserves at year-end act as a potential buffer against future risks.

USE OF RESOURCES
Continued

JOINT TRANSFORMATION PROGRAMME	RESPONSE	FINDINGS
The Council is currently in the process of undergoing a major Joint Transformation Programme (JTP) with Eastbourne Borough Council to provide more flexible, customer focused and cost effective services, both in the provision of frontline services and the organisation of back office functions.	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. 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 £1.6 million over the four year MTFS period. Total combined investment required specifically to deliver the JTP is £5.6 million, of which the Council's share is approximately £3.2 million. These costs will be met from the Council's strategic change earmarked reserve, which stood at £3.657 million at 31 March 2016.	Effective governance arrangements have been established to oversee delivery of the JTP with Eastbourne Borough Council. Risks associated with the project regarding the potential for ineffective change management processes, governance arrangements and engagement and consultation procedures, as well as the risk of the transformation not delivering the financial savings in the timescales required by the MTFS, are being appropriately managed. The projected savings and investment from the JTP have been adequately considered and factored into planning assumptions.

USE OF RESOURCES
Continued

NEW HOMES PROJECT	RESPONSE	FINDINGS
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 build a number of new Council homes across the district, and 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, we identified 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 have reviewed the governance and decision making processes followed by the Council in entering into the Conditional Sale Agreement, and subsequently terminating the agreement. The aim was 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 involved a review of relevant documents and Cabinet minutes, and discussions with management.	Overall the Council followed its own internal processes in making decisions about this project, and legal advice was sought on key decisions made. However, we identified scope for improvement in arrangements underpinning the project and agreed an action plan with the Council for lessons learnt from this project to be applied to future projects of this size and nature. Recommendations were raised with management in respect of : • Earlier disclosure of potential development sites • Public consultation in preliminary stages • Updating the Property Strategy and Asset Management Plan • A more structured approach to carrying out due diligence checks. The actions relate largely to good practice that could be implemented rather than significant weaknesses in processes.

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 7 October 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.

Our audit of the 2014/15 housing benefits subsidy claim identified a particularly high level of error within the cases tested, across all claim types. Full details of these errors were reported to the Audit and Standards Committee at their meeting on 20 June 2016. In addition, the Council was unable to fully reconcile benefit granted per its benefit software to benefit paid per its benefit software, and was unable to provide evidence that the software supplier's claim validation checking process had been fully complied with. As a result of these issues, and the significant additional work required by both the Council and the audit team, certification of the claim was delayed by several months.

Our work on the 2015/16 housing benefits subsidy claim is currently in progress. The deadline for the completion of this work is 30 November 2016, however discussions with officers have indicated that this work is likely to be delayed due to the level of errors encountered in previous years, which increases the total sample size to be tested this year. We remain in dialogue with the Council with the aim of completing this work as early as practically possible.

Pooling of housing capital receipts return

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 its pooling of housing capital receipts return for 2015/16. The deadline for completion of this work is 30 November 2016.

This assurance review is undertaken outside of our appointment by Public Sector Audit Appointments Ltd, and is instead covered by a tripartite agreement between the Council, DCLG and the auditor.

Our review of the 2014/15 return was completed before the deadline and identified no significant issues.

APPENDIX

Reports issues

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

REPORT	DATE
Audit Planning Report 2015/16	24 February 2016
Planning Letter 2016/17	18 April 2016
Grant Claims and Returns Certification 2014/15	21 April 2016
Audit Completion Report 2015/16	14 September 2016
Audit Completion Report 2015/16 (Updated)	6 October 2016

Fees

We reported our original fee proposals in our Audit Plan.

AUDIT AREA	PLANNED FEES	FINAL FEES
Code audit	46,418	46,418
Certification of housing benefits subsidy claim	14,960	14,960[(1)]
Fee for audit services	61,378	61,378
Audit related services:		
- Certification of pooling of housing capital receipts return	1,500	1,500[(1)]
Non audit related services:		
- None	-	-

(1) Fees for our grant certification work will be finalised following completion of the work.

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