

# East Hertfordshire District Council

Annual Audit Letter for the year ended 31 March 2016

October 2016

Ernst & Young LLP

## Contents

<b>Executive Summary</b> .....	<b>2</b>
<b>Purpose</b> .....	<b>5</b>
<b>Responsibilities</b> .....	<b>7</b>
<b>Financial Statement Audit</b> .....	<b>10</b>
<b>Value for Money</b> .....	<b>13</b>
<b>Other Reporting Issues</b> .....	<b>18</b>
<b>Focused on your Future</b> .....	<b>21</b>
<b>Appendix A</b> .....	<b>23</b>

In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ‘Statement of responsibilities of auditors and audited bodies 2015-16’. It is available from the Chief Executive of each audited body and via the PSAA website ([www.psaa.co.uk](http://www.psaa.co.uk))

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

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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

A hand with white nail polish is writing on a document with a blue pen. In the background, there is a calculator, a laptop, and a white mug. A yellow rectangular box is overlaid on the left side of the image.

## Executive Summary

## Executive Summary

We are required to issue an Annual Audit Letter to East Hertfordshire District Council (the Council) following completion of our audit procedures for the year ended 31 March 2016.

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

Area of Work	Conclusion
<b>Opinion on the Council's:</b>	
▶ Financial statements	Unqualified - the financial statements give a true and fair view of the financial position of the Council at 31 March 2016 and of its expenditure and income for the year then ended
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Statement of Accounts 2015/16
<b>Concluding on the Council's arrangements for securing economy, efficiency and effectiveness</b>	We concluded that you have put in place proper arrangements to secure value for money in your use of resources

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

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

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 30 September 2016
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 30 September 2016

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

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

Debbie Hanson  
Executive Director  
For and on behalf of Ernst & Young LLP

Purpose



## Purpose

### **The Purpose of this Letter**

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

We have already reported the findings from our audit work in our 2015/16 Audit Results Report which was presented to the 21 September 2016 meeting of the Audit and Governance Committee, representing those charged with governance. We issued our final Audit Results report, which include an update on the audit work that was ongoing as at 21 September, on 30 September. We do not repeat those detailed findings in this Letter. The matters reported here are the most significant for the Council.



# Responsibilities



## Responsibilities

### Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 2 March 2016 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
  - ▶ On the 2015/16 financial statements; and
  - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
  - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - ▶ Any significant matters that are in the public interest;
  - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

## **Responsibilities of the Council**

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

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

# Financial Statement Audit



## Financial Statement Audit

### Key Issues

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

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 30 September 2016.

Our detailed findings were reported to the 21 September 2016 meeting of the Audit and Governance Committee.

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

Significant Risk	Conclusion
<p><b>Management override of controls</b></p> <p>A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p>	<p>We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation.</p> <p>We have not identified any material weaknesses in controls or evidence of material management override.</p> <p>We have not identified any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.</p>
<p><b>Revenue and expenditure recognition</b></p> <p>Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation. We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the</p>	<p>Our testing has not revealed any material misstatements with respect to revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the Council's financial position.</p>

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year end.

For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.

Our testing did not identify any expenditure which had been inappropriately capitalised.

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Other Risk	Conclusion
<p><b>Purchase of Old River Lane</b></p> <p>The Council has purchased a significant investment property in Bishop's Stortford, part of which it had previously owned. This is a significant transaction with a value of £20.5 million.</p>	<p>We reviewed the acquisition and any subsequent revaluation of the acquired asset and confirmed that it had been correctly accounted for and appropriately disclosed in the financial statements.</p>

A close-up, shallow depth-of-field photograph of a stack of coins. The coins are stacked vertically, with some showing their edges and others showing their faces. The lighting is warm, highlighting the metallic texture and the embossed details on the coins. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Value for Money".

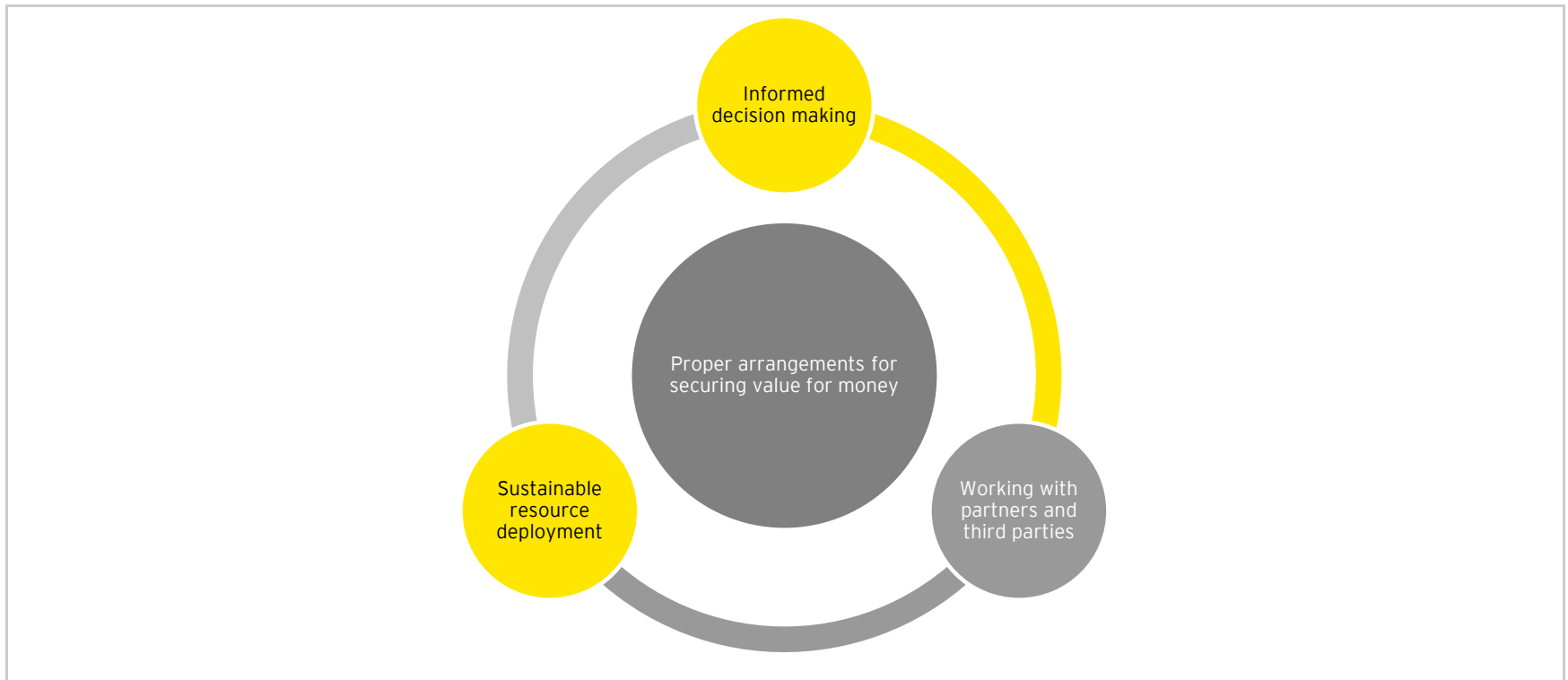
Value for Money

## Value for Money

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

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

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



We issued an unqualified value for money conclusion on 30 September 2016.

We identified three significant risks in relation to our value for money conclusion, relating to the following areas:

- Achievement of savings needed over the medium term (sustainable resource deployment);
- Arrangements for procuring supplies and services effectively to support the delivery of strategic priorities (sustainable resource deployment); and
- Governance arrangement for the purchase of Old River Lane (informed decision making).

We performed the procedures outlined in our Audit Plan and concluded that the Council had adequate arrangements in place.

As part of our work we considered the following areas and made the following observations.

## Key findings

### Achievement of Savings over the Medium Term

In its updated Medium Term Financial Plan, issued in February 2016, the Council identified a cumulative funding gap of £2.3 million over the next three years. Bridging this gap to ensure its future financial viability presents a significant challenge for the Council. One specific area of uncertainty for the Council is the £3 million of New Homes Bonus (NHB) grant currently included in the budget each year. As part of its response to this challenge, the Council has identified the need to generate efficiency savings and additional income of £1.3 million over the next four years. Given the scale of the savings needed and the uncertainties in future funding streams, there is a risk to the Council's future financial position.

As a result of this risk, we considered:

- The adequacy of the Council's budget monitoring process, comparing budget to outturn.
- The robustness of any assumptions used in medium term planning.
- The Council's approach to prioritising resources whilst maintaining services.
- The savings and income plans in place, and assessing the likelihood of whether these plans can provide the Council with the required savings and efficiencies over the medium term.

The main findings from the work we have undertaken are:

- The Council has appropriate budget monitoring arrangements and, based on the evidence provided, the Council are on track to deliver the majority of saving identified for 2016/17, with any remaining gap remaining within reasonable levels.
- The Council has a good record of delivering its budget and planned savings, having delivered savings of £0.797 million and £0.108 million in 2012/13 and 2013/14 respectively, while also underspending or breaking even on spend on services. This consistent performance indicates that the Council has a sound system of budgetary control.
- The Council's Medium Term Financial Plan (MTFP) is based on a number of assumptions, including estimates of future levels of



Government funding from areas such as Revenue Support Grant (RSG) and the New Homes Bonus (NHB) as well as income from areas such as council tax and business rates. The Council recognises the risks around these sources of income and the MTFP includes reasonable assumptions for reduction in RSG and NHB over future years. By the end of the spending review's four year settlement, the Council's RSG grant funding will have reduced to zero and this is reflected in the budget. The Council has also made prudent assumptions about the growth in the council tax base and the level of income from business rates.

- The Leadership Team has undertaken work to identify further savings to reduce the 2017/18 budget gap. While not all options will be viable, actions are being taken and this remains a top priority for senior management. There remains however a cumulative funding gap by 2018/19 of over £2 million for which efficiency savings have not as yet been fully identified or quantified. The Council is continuing to work on ways to reduce this gap, including developing strategies around waste and leisure and recreation. Given the Council's history of delivering savings and a balanced budget, we have concluded that it is likely that appropriate savings and efficiencies will be identified and delivered.
- At the end of 2016, the Council's General Fund balance was £3.8 million. This is significantly above minimal level of £3 million recommended by the Council's Finance Director. The Council also has earmarked reserves of £11.6 million and a general reserve of just under £1.2 million. The Council plans to use some of these reserves to help fund the budget gaps over the medium term, with £2.1 million allocated to bridge the 2016/17 funding gap. Some of the earmarked reserves are allocated towards specific items of spend but not all are specifically allocated and so could be released to support budgets in the short term if needed.
- While current projections are that the level of earmarked reserves would remain above the minimum level recommended by the Finance Director, reliance on the use of reserves on an ongoing basis to balance the budget is not sustainable. Although we recognise that this is part of a short term strategy to manage the period of transition during which efficiency savings are being identified to provide longer term solutions, this still presents a risk to the Council's future financial sustainability. Should efficiencies and savings not be identified to bridge the funding gaps in future years this would result in further reductions in the Council's reserves.

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#### **Arrangements for Procuring Supplies and Services**

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Following the issue of our Audit Plan in March 2016, we identified some weaknesses in the Council's arrangements for procuring supplies and services. The issues identified were that the Council did not have contracts with some of its suppliers and did not always source sufficient quotes from suppliers for the provision of goods and services.

As a result of the issues identified we reviewed a sample of procurements undertaken during the year to confirm that appropriate quotations had been obtained in line with the Council's procedures. Our testing found that the appropriate number of quotes had been obtained for the sample of contracts we tested.

Our work did however identify some weaknesses in the Council's arrangements, including the lack of a complete and accurate contracts register. The lack of such a register means that the Council may fail to identify on a timely basis contracts that are due for renewal and may therefore not be able to put in place appropriate procurement arrangements to ensure the best value for money.

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### **Governance Arrangements for the Purchase of Old River Lane**

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During 2015/16, the Council purchased a significant investment property in Bishop's Stortford, part of which it had previously owned. This was a significant transaction outside the Council's normal activities.

We therefore considered the governance arrangements relating to the purchase to ensure it was supported by appropriate decision making arrangements.

Our approach focused on assessing whether the arrangements supporting the decision:

- Demonstrate the application of the principles and values of sound governance.
- Used appropriate and reliable financial and performance information to support the decision.
- Provide evidence that the risk related to the acquisition have been clearly identified and managed effectively.

We found that:

- The decisions relating to the purchase were supported by appropriate reports including analysis of financial information; and
  - The risks related to the procurement have been identified and are being managed.
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## Other Reporting Issues

## Other Reporting Issues

### Whole of Government Accounts

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

### Annual Governance Statement

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

We completed this work and did not identify any areas of concern.

### Report in the Public Interest

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

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

### Written Recommendations

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

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

### Objections Received

We did not receive any objections to the 2015/16 financial statements from any member of the public.

### Other Powers and Duties

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

## **Independence**

We communicated our assessment of independence in our Audit Results Report to the Audit and Standards Committee on 7 September 2016. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

## **Control Themes and Observations**

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

A close-up photograph of a person's hands holding binoculars to their eyes. The person's face is partially visible in the background, looking through the lenses. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Focused on your future".

Focused on your  
future

## Focused on your Future

Area	Issue	Impact
<b>EU referendum</b>	<p>Following the majority vote to end the UK's membership of the European Union (EU) in the EU Referendum held on 23 June 2016 there is a heightened level of volatility in the financial markets and increased macroeconomic uncertainty in the UK. All three major rating agencies (S&amp;P, Fitch and Moody's) took action on the UK Sovereign credit rating and, following the rating action on the UK Government. For entities in the public sector, there is likely to be an impact on investment property valuations if confidence in the wider UK property market falls; and the valuation of defined benefit pension obligations may also be affected. It is too early to estimate the quantum of any impact of these issues, but there is likely to be significant ongoing uncertainty for a number of months while the UK renegotiates its relationships with the EU and other nations.</p>	<p>Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of the referendum and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions.</p> <p>We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will engage with you on the concerns and questions you may have, provide our insight at key points along the path, and provide any papers and analysis of the impact of the referendum on the Government and Public Sector market.</p>

Appendix A

## Audit Fees





## Audit Fees

Our planned audit fee for 2015/16 is broadly in line with the scale fee set by PSAA and the planned fee reported in our 2015/16 Audit Plan.

Description	Final Fee 2015/16 £'s	Planned Fee 2015/16 £'s	Scale Fee 2015/16 £'s
<b>Audit Fee - Accounts code work</b>	*53,102	52,331	52,331
<b>Audit Fee - Grant claims work</b>	**8,316	8,316	8,316
<b>Total</b>	61,418	60,647	60,647

\* A scale fee variation of £771 has been proposed regarding the additional work that we were required to undertake in response to the significant risks identified in relation to our value for money conclusion. This proposed fee has been agreed with the Council and is subject to approval PSAA.

\*\* We are currently undertaking our audit of the Council's Housing Benefit Subsidy claim and will report on the final fees charged in our certification report to be issued to the Council in February 2017.

We confirm we have undertaken no non-audit work outside of the Code requirements.

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ED None

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