

Test Valley Borough Council

Annual Audit Letter for the year ended 31 March 2017

October 2017

Ernst & Young LLP



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Public Sector Audit Appointments Ltd (PSAA) have issued a “Statement of responsibilities of auditors and audited bodies”. It is available from the Chief Executive of each audited body and via the PSAA website (www.psa.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 (updated 23 February 2017)” 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 Test Valley Borough Council (the Council) following completion of our audit procedures for the year ended 31 March 2017.

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

| Area of Work | Conclusion |
|---|--|
| Opinion on the Council's: ▶ Financial statements | Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2017 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 Annual Accounts. |
| Concluding on the Council's arrangements for securing economy, efficiency and effectiveness | We concluded that the Council has put in place proper arrangements to secure value for money in its use of resources. |

| Area of Work | Conclusion |
|---|---|
| Reports by exception: ▶ 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 |
|--|--|
| Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA). | The Council is below the specified audit threshold of £350 million. Therefore, the NAO did not require us to 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 14 September 2017. |
| 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 28 September 2017. |

We anticipate issuing a report to those charged with governance of the Council summarising the certification work we have undertaken on the 2016/17 housing benefits claim in December 2017.

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

Maria Grindley

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 detailed findings from our audit work in our 2016/17 Audit Results Report to the 21 September 2017 Audit Panel and 27 September 2017 General Purposes Committee, representing those charged with governance. 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 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued on 27 February 2017 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 2016/17 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 Council is below the specified audit threshold of £350 million. Therefore, the NAO did not require us to perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, 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.

A blurred office desk with a laptop, glasses of water, and financial documents. The scene is brightly lit, likely from a window with blinds in the background. A yellow rectangular box is overlaid on the left side of the image, containing the text 'Financial Statement Audit'.

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 28 September 2017.

Our detailed findings were reported to the 21 September Audit Panel and 27 September 2017 General Purposes Committee.

In our report, which we issued on 14 September 2017, we noted that there were some areas where our work was outstanding and was to be completed. We completed work in those areas and this enabled us to issue an unqualified audit report on the Council's financial statements. There were no matters arising from the completion of our work that needed to be reported to the Audit Panel and General Purposes Committee.

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

| Significant Risk | Conclusion |
|---|--|
| <p>Management override of controls</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.</p> | <p>We have not identified any evidence of management override. We did not identify any errors in the financial statements or indications of fraud. We did not identify any inappropriate journal entries (or other adjustments) that impacted on the financial statements.</p> |
| | <p>We have not identified any instances of inappropriate judgements being applied in making estimates. We gave specific consideration to bad debt provisions.</p> |
| <p>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 did not identify any transactions during our audit which appeared unusual or outside the Council's normal course of business.</p> |
| | <p>We did not identify any indications of management override through our testing of the Movement in Reserves Statement.</p> |

| Other Key Findings | Conclusion |
|---|---|
| <p>Amendments were made to the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the Code) this year changing the way the financial statements are presented.</p> | <p>The disclosures made were generally in line with the Code. We identified a small number of presentational changes and additional disclosures that management agreed to make in the final statement of accounts. The main points identified were the need to add a narrative note explaining the prior period adjustments resulting from the Code changes, and to show prior period comparators as “restated”.</p> |
| <p>The new reporting requirements impact the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS), and include the introduction of the new ‘Expenditure and Funding Analysis’ note (EFA).</p> | <p>We have reviewed the working papers supporting the derivation of these figures, how the ledger system has been re-mapped to reflect the Council’s organisational structure, and how overheads are apportioned across the service headings. We had no matters to report. Good quality working papers were provided which allowed us to understand the manual process undertaken to format data from the ledger in line with the new presentation of the financial statements for 2016/17.</p> |
| <p>The Code now requires that the analysis presented in the CIES and EFA to be based on the organisational structure under which the authority operates. This change required new disclosure notes and a full retrospective restatement of impacted primary statements.</p> | <p>We have agreed the restated comparative figures back to the Council’s supporting working papers and ledger. We did not identify any matters to report.</p> |
| <p>We reviewed the EFA, CIES, MiRS and notes to ensure compliance with the Code. We reviewed the working papers supporting the statements and notes, for both the current and prior year.</p> | |

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

| Item | Thresholds applied |
|----------------------|---|
| Planning materiality | <p>We determined planning materiality to be £1.396 million (2016: £1.358 million), which is 2% of gross revenue expenditure reported in the accounts of £86.877 million (excluding £17.072 million business rates expenditure)</p> <p>We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p> |
| Reporting threshold | <p>We agreed with the Audit Panel and General Purposes Committee that we would report all audit differences in excess of £0.07 million (2016: £0.068 million)</p> |

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. There were no uncorrected misstatements identified during the course of our audit. The only matters identified were some minor disclosure and presentational issues, which were corrected by management.

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 ridges on the edges. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Value for Money".

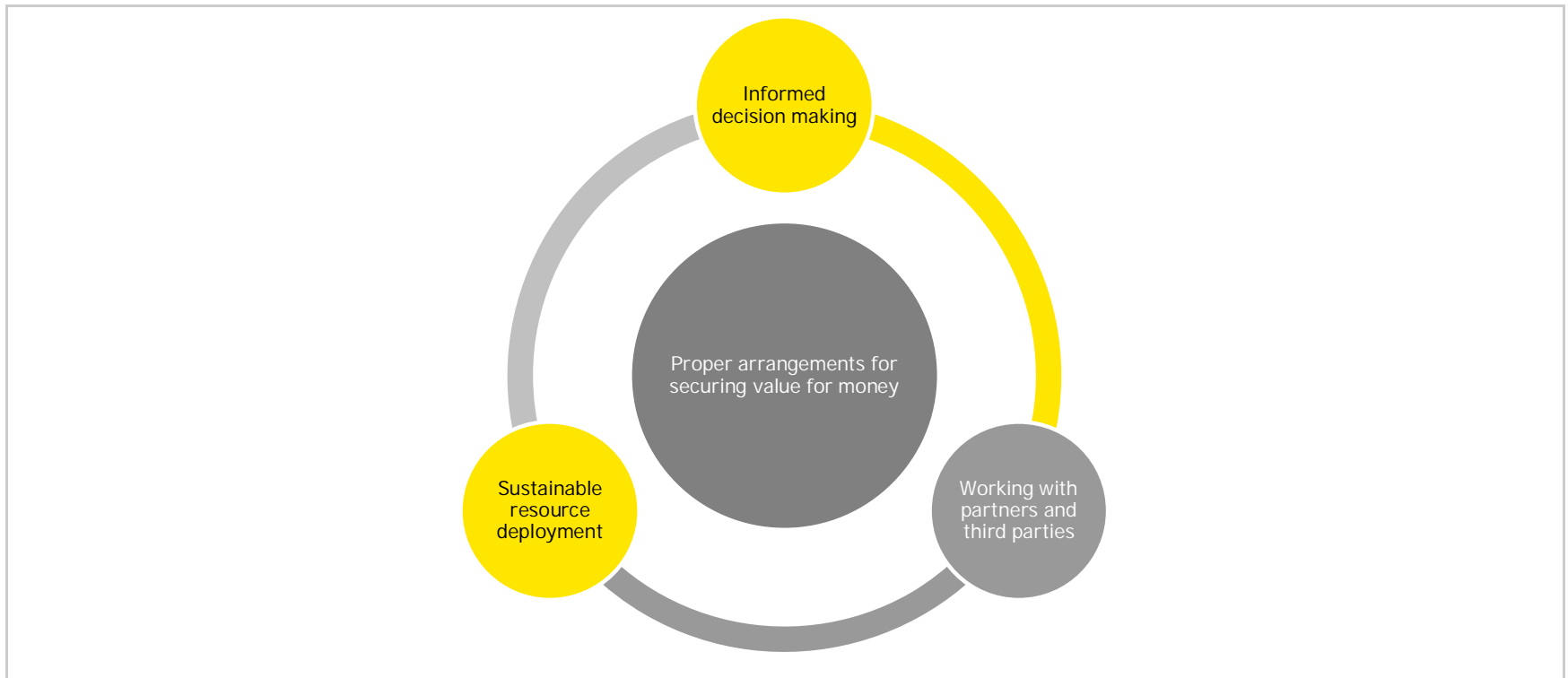
Value for Money

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 identified one significant risk in relation to these arrangements. The tables below present the findings of our work in response to the risk identified.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions, worked effectively with partners and other third parties, and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore issued an unqualified value for money conclusion on 28 September 2017.

| Significant Risk | Conclusion |
|---|---|
| <p>During 2016/17, the Council undertook a process to let a new long-term contract for the provision of leisure services in the Test Valley area. The contract will run for 30 years from 1 April 2017 and will include significant investment to improve the Borough's leisure facilities.</p> | <p>We held discussions with the Head of Finance to understand the contract procurement process and matters arising in relation to the transition between providers.</p> <p>We reviewed all committee papers pertaining to the leisure contract to further understand the contract award process, and the information provided to members to allow them to make informed decisions. This furthermore allowed us to review the robustness of arrangements around the transition between providers and how issues relating to this element of the process were addressed.</p> |
| <p>The contract award was made in November 2016 and will see Places for People taking over the running of these services from the previous provider, Valley Leisure.</p> | <p>We reviewed the revenue projections and capital financing plans underpinning the contract, to understand its impact on the Council's future financial position and how this is being factored into the Council's medium term financial plans</p> |
| <p>As a significant and high value contract, there is a need to ensure a robust process for the financial planning and implications around the contract.</p> | <p>No significant weaknesses in arrangements were identified. From the evidence provided we concluded that officers maintained robust processes to inform members of developments and seek their approval at all key stages of the contract award process. The Council made appropriate use of external advisors and internal staff in establishing and running the tendering and contract evaluation processes. Some difficulties were encountered in the handover from the old provider to the successful bidder; these were dealt with reasonably given the realities of the situation. The new contract is forecast to bring significant net revenue benefit to the Council over its 30 year life, and as such is expected to strengthen the Council's overall financial position in the medium and longer term. This will need to be kept under review in the coming years as the contract is implemented.</p> |



Other Reporting
Issues

Other Reporting Issues

Whole of Government Accounts

The Council is below the specified audit threshold of £350 million. Therefore, the NAO did not require us to 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 2016/17 financial statements from 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 Panel on 21 September 2017 and to the General Purposes Committee on 27 September 2017. 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

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach other than for housing benefits, and have therefore not tested the operation of controls of other financial systems.

Our audit did not identify any controls issues to bring to the attention of the Audit Panel and General Purposes Committee.

A close-up photograph of a person's face as they look through a pair of black binoculars. The person's eyes are focused on the lenses, and their hands are visible holding the device. The background is a soft, out-of-focus white. 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 |
|--|---|---|
| <p><i>Earlier statutory deadline for production and audit of the financial statements from 2017/18</i></p> | <p>The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.</p> | <p>These changes provide challenges for both the preparers and the auditors of the financial statements.</p> <p>As auditors, nationally we have:</p> <ul style="list-style-type: none"> • Issued a thought piece on early closedown; • As part of the strategic Alliance with CIPFA jointly presented accounts closedown workshops across England, Scotland and Wales; and • Presented at CIPFA early closedown events and on the subject at the Local Government Accounting Conferences in July 2017. <p>To prepare for this change both we and the Council targeted achievement of the earlier completion of work in 2016/17.</p> <p>Moving forward, we will need to continue to work together collaboratively to ensure the necessary changes are made to working practices both at the Council and among the audit team, to ensure the new statutory deadlines are met in 2017/18.</p> |
| <p><i>IFRS 9 Financial Instruments</i></p> | <p>Applicable for local authority accounts from the 2018/19 financial year and will change:</p> <ul style="list-style-type: none"> • How financial assets are classified and measured • How the impairment of financial assets are calculated • Financial hedge accounting • The disclosure requirements for financial assets. <p>Transitional arrangements are included within the accounting standard, however as the 2018/19 Accounting Code of Practice for Local Authorities</p> | <p>Although some initial thoughts on the approach to adopting IFRS 9 have been issued by CIPFA, until the Code is issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Authority will have to:</p> <ul style="list-style-type: none"> • Reclassify existing financial instrument assets • Re-measure and recalculate potential impairments of those assets; and • Prepare additional disclosure notes for material items |

| Area | Issue | Impact |
|---|---|---|
| | <p>has yet to be issued it is unclear what the impact on local authority accounting will be and whether any accounting statutory overrides will be introduced to mitigate any impact.</p> | |
| <p><i>IFRS 15 Revenue from Contracts with Customers</i></p> | <p>Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except:</p> <ul style="list-style-type: none"> • Leases; • Financial instruments; • Insurance contracts; and • for local authorities; Council Tax and NDR income. <p>The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.</p> <p>There are transitional arrangements within the standard; however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be.</p> | <p>As with IFRS 9, some initial thoughts on the approach to adopting IFRS 15 have been issued by CIPFA. However, until the Code is issued there remains some uncertainty. However, what is clear is that for all material income sources from customers the Authority will have to:</p> <ul style="list-style-type: none"> • Disaggregate revenue into appropriate categories • Identify relevant performance obligations and allocate income to each • Summarise significant judgements |
| <p><i>IFRS 16 Leases</i></p> | <p>Applicable for local authority accounts from the 2019/20 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease in a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard, although as the 2019/20 Accounting</p> | <p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to classify all of its leases and therefore must ensure that all lease arrangements are fully documented.</p> |

| Area | Issue | Impact |
|------|--|--------|
| | Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be or whether any statutory overrides will be introduced. | |

Appendix A

Audit Fees



Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our 14 September 2017 Annual Results Report.

| Description | Final Fee 2016/17 £ | Planned Fee 2016/17 £ | Scale Fee 2016/17 £ | Final Fee 2015/16 £ |
|---|------------------------------|--------------------------|------------------------|------------------------|
| Total Audit Fee – Code work | 52,830 | 52,830 | 52,830 | 52,830 |
| Total Audit Fee – Certification of claims and returns | To be confirmed ^a | 11,210 ^b | 14,012 | 10,980 |

^aThe final fee for the certification of claims and returns for 2016/17 remains subject to completion of our work, the deadline for which is 30 November 2017.

^bWe have agreed that the Council will perform some of the initial Housing Benefit certification testing itself in 2016/17. This is in return for an approximate 20% reduction in our fee. We will do sufficient checking to satisfy ourselves that this testing has been performed appropriately.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

EY | Assurance | Tax | Transactions | Advisory

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ED None

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