Item 2

Audit and Standards Committee

7 December 2017

External Auditors Annual Audit Letter 2016/17

Recommendation

The Committee is asked to consider the Annual Audit Letter of the External Auditors, attached at Appendix A, including whether any executive action is required.

1. Purpose of the Report

1.1. The Audit Commission's Code of Audit Practice requires auditors to prepare an annual audit letter and issue it to each audited body.

1.2. The purpose of preparing and issuing annual audit letters is to communicate to the audited body and key external stakeholders, including members of the public, the key issues arising from auditors' work, which auditors consider should be brought to the attention of the audited body. The annual audit letter covers the work carried out by auditors since the previous annual audit letter was issued.

1.3. This letter, for 2016/17, is attached at **Appendix A**. This has previously been circulated to the Committee for information. It summarises all of the work completed as part of the 2016/17 annual audit and reported to this Committee in previous reports and provides a brief update on any issues since the last report to the Committee in September.

1.4. The Engagement Lead will attend the meeting to present the report.

2. Background Papers

None.

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Local Members consulted
Not applicable

Other Members consulted
None

The Annual Audit Letter for Warwickshire County Council and Warwickshire Pension Fund

Year ended 31 March 2017

October 2017

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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work we have carried out at Warwickshire County Council (the Council), including the Warwickshire Pension Fund (the Pension Fund), for the year ended 31 March 2017.

This Letter provides a commentary on the results of our work to the Council and its external stakeholders, and highlights issues we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit and Standards Committee (as those charged with governance) in our Audit Findings Reports on 6 September 2017.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's and the Pension Fund's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's and the Pension Fund's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's and the Pension Fund's financial statements on 25 September 2017.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2017. We reflected this in our audit opinion on 25 September 2017.

Use of additional powers and duties

We are required under the Act to give electors the opportunity to raise questions about the Council's accounts and we consider and decide upon objections received in relation to the accounts.

We have received objections in respect of the Council's:

- arrangements in respect of the installation and repairs and maintenance of manhole covers, and
- responsibilities under the Environmental Noise (England) Regulations 2006.

We have met with the Council and reviewed council policies and documentation. The Council has recently provided us with further information which we are in the process of considering. Once this is complete we will be in a position to issue provisional views to the objector and the Council.

Whole of government accounts

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 25 September 2017.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of Warwickshire County Council as we have not yet completed our work in respect of the objections received as noted above.

Working with the Council and Pension Fund

During 2016/17 we have continued to support the Council through the provision of our CFO Insights service, our online analysis tool providing you with access to insight on the financial performance, socio-economy context and service outcomes of councils across the country.

We also completed work on the Council's 2015/16 Teachers Pension return in November 2016.

Other areas where we have continued to work with the Council and Pension Fund throughout 2016/17 include:

- **Regular discussion and liaison on the accounts audit process** as we further develop our partnership approach to ensuring that the early close deadline in 2017/18 is met.
- **Sharing our insight –** through regular updates to officers and the Audit and Standards Committee.
- **Supporting development –** sharing publications on areas such as Income Generation, Devolution and Local Authority Trading Companies.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by Council and Pension Fund staff.

Grant Thornton UK LLP
October 2017

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we applied the concept of materiality to determine the nature, timing and extent of our work, and to evaluate the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £14,351k, which is 1.8% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for disclosures on related party transactions and senior officer remuneration due to increased public interest in these disclosures. We set a threshold of £718k above which we reported errors to the Audit and Standards Committee.

Pension Fund

For the audit of the Warwickshire Pension Fund accounts, we determined materiality to be £19,838k, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a lower level of specific materiality for certain areas such as management expenses and related party transactions. We set a threshold of £992k above which we reported errors to the Audit and Standards Committee.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by the Head of Finance are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts included in the Statement of Accounts on which we gave our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts – Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
The revenue cycle includes fraudulent transactions **Management over-ride of controls** Under ISA (UK&I) 240 there are presumed risks of management over-ride of controls being present in all entities and that revenue may be misstated due to the improper recognition of revenue.	Having considered the risk factors set out in ISA 240 and the nature of the revenue streams at Warwickshire County (WCC), we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including WCC, mean that all forms of fraud are seen as unacceptable. In respect of management over-ride of controls we reviewed: • journal entry processes and selected unusual journal entries for testing back to supporting documentation • accounting estimates, judgements and decisions made by management, and • reviewed unusual significant transactions.	Our audit work did not identify any issues in respect of revenue recognition or evidence of management over-ride of controls.
Valuation of pension fund net liability The Council's pension fund net liability, as reflected in its balance sheet ,represents a significant estimate in the financial statements.	• Identifying the controls put in place by management to ensure that the pension fund net liability is not materially misstated and assessing whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement. • Review of the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation. • Gaining an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made. • Review of the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary.	Our audit work did not identified any significant issues in relation to the risk identified.

Audit of the accounts – Council (continued)

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of property, plant and equipment The Council revalues its assets on a rolling basis over a five year period. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from the current value. This represents a significant estimate by management in the financial statements.	• Review of management's processes and assumptions for the calculation of the estimate. • Review of the competence, expertise and objectivity of any management experts used. • Review of the instructions issued to valuation experts and the scope of their work • Discussions with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions. • Review and challenge of the information used by the valuer to ensure it was robust and consistent with our understanding. • Testing of revaluations made during the year to ensure they were input correctly into the Council's asset register • Evaluation of the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value.	Our audit work did not identify any significant issues in relation to the risk identified. We were satisfied that, based on review of the assessment undertaken by the Council supported by our own review of independently provided indices and other supporting information on valuation movements, the Council's assessment that the carrying value of property, plant and equipment was not materially different from the current value at the balance sheet date was reasonable and based on appropriate evidence and assumptions. We noted that the Council's internal valuations team had not considered movements in building indices/tender prices when considering potential movements in the fair value of assets held at Depreciated Replacement Cost, such as school buildings. We consider that such indices would appropriate to apply when considering the valuation of assets held at Depreciated Replacement Cost. However, our own assessment using national indices for building tender prices as supplied by independent valuers suggests that any potential movement on the value of assets held at Depreciated Replacement Cost would not be material. We recommended that the Council's internal valuation team include review of tender price indices for assets held at Depreciated Replacement Cost in all future reviews of whether the carrying value of assets is materially different to current value. The Council has agreed to consider this as part of a review of the approach taken to the valuation of assets in preparation for the 2017/18 accounts.

Audit of the accounts – Council (continued)

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Changes to the presentation of local authority financial statements CIPFA has been working on the 'Telling the Story' project, for which the aim was to streamline the financial statements and improve accessibility to the user and this has resulted in changes to the 2016/17 CIPFA Code of Practice. The changes affect the presentation of income and expenditure in the financial statements and associated disclosure notes. A prior period adjustment (PPA) to restate the 2015/16 comparative figures is also required.	• Documented and evaluated the process for the recording the required financial reporting changes to the 2016/17 financial statements • Reviewed the re-classification of the Comprehensive Income and Expenditure Statement (CIES) comparatives to ensure that they are in line with the Council's internal reporting structure • Reviewed the appropriateness of the revised grouping of entries within the Movement In Reserves Statement (MIRS) • Tested the classification of income and expenditure for 2016/17 recorded within the Cost of Services section of the CIES • Tested the completeness of income and expenditure by reviewing the reconciliation of the CIES to the general ledger • Tested the classification of income and expenditure reported within the new Expenditure and Funding Analysis (EFA) note to the financial statements • Reviewed the new segmental reporting disclosures within the 2016/17 financial statements to ensure compliance with the CIPFA Code of Practice.	We considered that the Council met all requirements of the 2016/17 CIPFA Code of Practice in the preparation of its 2016/17 financial statements with the exception of the point noted below. The Code requires that, as well as restating the 2015/16 CIES comparative figures in line with the new reporting format, authorities should disclose "the amount of the adjustment for each financial statement line item affected" – i.e. provide a reconciliation between the 2015/16 CIES figures as previously reported in the 20151/6 financial statements and the restated comparatives included in the 2016/17 financial statements. Warwickshire County Council did not include this reconciliation in its 2016/17 financial statements on the basis that omission of this disclosure would not have a material impact on the understanding of users of the accounts as the Net Cost of Services and all lines below it in the CIES for 2015/16 remains unchanged. Instead the Council included a general narrative statement to explain the impact of the change. We considered that, whilst the Council has not fully complied with the requirements of the 2016/17 CIPFA Code of Practice by providing disclosure of the impact of the restatement of the 2015/16 CIES figures on each financial statement line affected, we agreed that this omission would not have a material impact on the understanding of users of the accounts and so did not consider that there was any impact on our opinion on the financial statements.

Audit of the accounts – Pension Fund

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the pension fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Level 3 Investments (Valuation is incorrect) Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. The measurement inputs for Level 3 investments are unobservable inputs and therefore by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.	• We updated our understanding of the Pension Fund's process for valuing Level 3 investments through discussions with relevant personnel during the interim audit and performed walkthrough tests of the controls identified in the process. • On a sample basis we tested valuations by obtaining and reviewing the audited accounts at latest date for individual investments and agreed these to the fund manager reports at that date. In addition we reconciled those values to the values at 31st March with reference to known movements in the intervening period. • Reviewed the qualification of the fund managers as experts to value the level 3 investments at year end and gained an understanding of how the valuation of these investments has been reached. • Reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments. • Reviewed the competence, expertise and objectivity of management experts used.	Our audit work did not identify any issues in respect of Level 3 investments. As noted the valuation of these investments are subject to a degree of judgement and estimation. Our testing compared the valuation of Level 3 assets as reported by the custodian to the value as reported by the individual fund manager. This identified that the value reported by the fund managers was £5.9m more than that reported by the custodian. £5.3m of this related to investments held with Harbourvest. The differences were investigated and are not material to the Pension Fund. The difference can be explained as resulting from differing estimation techniques being used by the fund manager and the custodian and timing differences. In addition, we reviewed the valuation of the investments reported by the custodian and compared this to the latest audited accounts where they are available. For Harbourvest we noted that a review of the accounts suggests a valuation of £70.0m when compared to the custodian value of £66.2m, a difference of £3.8m. The direction of the valuation difference is consistent with the differences identified above For Blackstone, the audited accounts show £82.6m when compared to the custodian of £84.3m, a difference of £1.7m. These differences are not material and below our expectation of tolerable error. We are therefore satisfied that the estimate is as a result of applying an appropriate estimation technique and no amendment was required to the accounts.

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's and the Pension Fund accounts on 25 September 2017, in advance of the 30 September 2017 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of supporting working papers. The finance team responded promptly and efficiently to our queries during the audit.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of both the Council and the Pension Fund to the Audit and Standards Committee on Committee on 6 September 2017.

We identified no adjustments affecting the reported financial position as set out in the draft financial statements for the Council and the Pension Fund, and recommended only a small number of adjustments to improve the presentation of the financial statements.

Preparations for early close 2017/18

In preparation for the earlier sign off deadline of 31 July which will apply for the sign off of your 2017/18 accounts, we sought to complete most of our audit work during June 2017 and issue our draft Audit Findings Report by the end of July. We are pleased to report that, by working closely with the Council's finance staff throughout the year, we were able to achieve this although we have identified some areas where we consider that the efficiency and effectiveness of our audit process can be further improved. Overall, we consider that the Council is well prepared to achieve the early close timetable set for 2017/18.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO. We issued a group assurance certificate which did not identify any issues for the group auditor to consider on 25 September 2017.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have received objections in respect of the Council's:

- arrangements in respect of the installation and repairs and maintenance of manhole covers, and
- responsibilities under the Environmental Noise (England) Regulations 2006.

We have met with the Council and reviewed council policies and documentation. The Council has recently provided us with further information which we are in the process of considering. Once this is complete we will be in a position to issue provisional views to the objector and the Council.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2016 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out in tables overleaf.

Overall VfM conclusion

We were satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2017.

Value for Money (continued)

Risk identified	Work carried out	Findings and conclusions
Sustainable resource deployment The Council has a "One Organisation Plan 2014-2018" (now updated to OOP 2020) in place which identified the need to make significant savings. Our assessment in 2015/16 was that the Council had delivered required levels of savings identified since the OOP was first developed in 2014 but the update to 2020 in 2017 has identified the need for a further £67m of savings by 2020.	We reviewed • the extent to which the medium term financial plan (One Organisation Plan) remains robust and was based on reasonable assumptions • arrangements for agreement and approval of 2017/18 budgets • progress made in identification and agreement of plans to deliver savings of £67m by 2020 • outturn against the plan for 2016/17 and progress made in 2017/18 to date	The One Organisational Plan (OOP) as updated in February 2017 now covers the period to 2020 and sets out: • £92m savings delivered to date • £67m further savings required by 2020. The full 2017/18 revenue budget was approved by Council in February 2017 and sets out: • Overall direction of travel – i.e. setting this in the context of the OOP 2020 • Key focus is on delivery of savings - £67m by 2020 – and the impact that this has on 2017/18 • 1.99% increase in council tax and 2% ASC levy on top, so 3.99% total increase • Specific provision for key changes such as the impact of apprenticeship levy and the living wage • Includes commentary on key risks to delivery of the budget. The 2017/18 budget document includes full listing of the areas of agreed delivery savings which support the £67m required figure over 3 years to 2020. These agreed savings were developed based on extensive consultation with and scrutiny by heads of service and staff, staff within finance service, corporate board and members. The 2016/17 outturn report presented to Cabinet in July 2017 shows: • Underspend vs revenue budgets in 2016/17 of £9.864m, largely due to one off income and early delivery of some savings • Savings delivered in 2016/17 of £14.536m vs target of £16.262m. The shortfall of £1.724m to be carried forward and delivered in 2017/18 • £17.791m slippage on capital programme, mainly due to slippage on transport schemes. • Overall total savings delivered over period 2014 – 2017 totalled £45.645m compared to target of £46.055. **Review of evidence of progress on delivery of the 2017/18 savings plans and budgets to July 2017 did not highlight any significant issues which would suggest overall delivery is at risk. On this basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions for the year ended 31 March 2017.**

Value for Money (continued)

Risk identified	Work carried out	Findings and conclusions
Working with other partners A number of the Council's key ambitions within the OOP rely on the effectiveness of working arrangements with other partners such as health bodies.	We reviewed evidence from the Council's progress in hitting targets and ambitions as set out in the One Organisational Plan to assess what evidence this provides at to the effectiveness of partnership working arrangements.	The One Organisational Plan Year End Progress report for 2016/17 was presented to Cabinet in July 2017. The overall rating on performance against targets for 2016/17 as set out in this report was "Amber". This was in line with the overall rating for 2015/16 which was also "Amber". The commentary states that 2016/17 was considered to be the most challenging year of the OOP 2014-2017 and the overall amber rating is a reflection of this. 59% of Key Business Measures supporting OOP outcomes had been achieved for 2016/17, which is in line with performance in previous years of the OOP (55% of targets were achieved in 2015/16, 59% in 2014/15). The range of targets not met is broad and does not point to a particular failing in any one particular area, and the overall level of performance is consistent with that reported in the 2 previous years around delivery of OOP objectives. Key themes set out in the OOP were around: • Delivery of savings • Transformation of ASC • Working with health partners to maximise and align resources • Modernisation and collaboration for fire and rescue services • Economic growth supported by Capital Growth Fund • Investing in assets to support service delivery • Highways drainage and flooding improvements • Investing in safer transport for public, schools and social care • Reduce workforce by 11% The OOP outturn report confirms that progress continues to be made against all these themes but challenges remain. The report sets out clear actions and responses in all areas where targets were not met in 2016/17. **Review of the detailed report did not highlight any areas where there have been significant failings or weaknesses in arrangements in 2016/17. On this basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements for working with third parties effectively to deliver strategic priorities for the year ended 31 March 2017.**

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and provision of non-audit services.

Fees

	2016/17 Planned fees £	2016/17 Actual fees £	2015/16 Actual fees £
Statutory audit of Council	94,539	94,539	94,539
Statutory audit of Pension Fund	23,892	23,892	23,892
Agreed fee variation - Pension Fund	1,328	1,328	1,328
Total fees (excluding VAT)	**119,759**	**119,759**	**119,759**

The proposed fees for the year were in line with the scale fee and agreed fee variations as set by Public Sector Audit Appointments Ltd (PSAA).

Reports issued

Report	Date issued
Audit Plan – Council	February 2017
Audit Plan – Pension Fund	April 2017
Audit Findings Report – Council	August 2017
Audit Findings Report – Pension Fund	August 2017
Annual Audit Letter	October 2017

Fees for other services

Service	Fees £
Audit related services:	
• Teacher's Pension return certification	£4,200
Non-audit services	
• CFO Insights	£0*

Non- audit services

- * A £30,000 for a three year subscription to CFO insights was paid by the Council in 2015/16 and reported in our 2015/16 Audit Findings Report.
- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all other services which were identified.
- We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place, as reported in our Audit Findings Report.

Reports issued and fees continued

We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards have been applied to mitigate these risks.

	Service provided to	Fees	Threat identified	Safeguards
Audit related services	Certification of Teachers Pension return for Warwickshire County Council (2016-17)	£4,200	• Self interest	This is a recurring fee and therefore a self interest threat exists. However, the level of this recurring fee taken on its own is not considered to be a significant threat to independence as the fee for this work in comparison to the total fee for the audit (£94,539) for the Council and in particular to Grant Thornton UK LLP overall turnover. Furthermore, the work relates to audit related services for which there is a fixed fee and no contingent element to the fee. These factors are deemed to adequately mitigate the perceived self interest threat to an acceptable level.
Non-audit services	CFO Insights	£0*	• Self interest	A £30,000 for a three year subscription to CFO insights was paid by the Council in 2015/16 and reported in our 2015/16 Audit Findings Report. This is a recurring fee and therefore a self interest threat exists. However, the level of this recurring fee taken on its own is not considered to be a significant threat to independence as the fee for this work in comparison to the total fee for the audit (£94,539) for the Council and in particular to Grant Thornton UK LLP overall turnover. Furthermore, the work relates to non-audit related services for which there is a fixed fee and no contingent element to the fee. These factors are deemed to adequately mitigate the perceived self interest threat to an acceptable level.
	TOTAL	£4,200		

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor and have been approved by the Audit and Standards Committee.