

Audit and Standards Committee

29 November 2018

External Auditors' Annual Audit Letter 2017/18

Recommendation

That the Committee 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 letter was issued.
- 1.3. This letter, for 2017/18, is attached at **Appendix A**. It summarises all of the work completed as part of the 2017/18 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 July.
- 1.4. The auditors will attend the meeting to present the report.

2. Background Papers

- 2.1. None.

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Local Members consulted

Not applicable

Other Members consulted

None



Annual Audit Letter

Year ending 31 March 2018

Warwickshire County Council and Warwickshire Pension Fund

19 August 2018



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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Warwickshire County Council (the Council) for the year ended 31 March 2018, including the Warwickshire Pension Fund (the Pension Fund) accounts.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that 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 and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We consider the Council to be those charged with governance but have determined our communications should be with the Council's Audit & Standards Committee.

Our work

Materiality	We determined materiality for the audit of the Council's financial statements to be £14.351m, which is 1.8% of the Council's gross revenue expenditure. We determined materiality for the audit of the Pension Fund accounts administered by the Council to be £19.838m, which is 1% of the Pension Fund's net assets.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements on 27 July 2018. We gave an unqualified opinion on the pension fund accounts of Warwickshire Pension Fund on 27 July 2018.
Whole of Government Accounts (WGA)	We completed our work on the Council's consolidation return following guidance issued by the NAO and issued our assurance statement on 8 August 2018.
Use of statutory powers	We are required under the Act to give electors the opportunity to raise questions about the Council's financial statements and we consider and decide upon objections received in relation to the accounts. We received two highways related objections on prior year accounts. We have issued provisional reviews and once we have received and considered any further representations from the objector we will finalise our conclusions. In addition, we received an objection to the 2017/18 financial statements on the 12 July 2018. We are in the process of carrying out preliminary enquiries with the Council to determine whether we are required to consider the matters you brought to our attention.
Value for Money arrangements	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 25 July 2018.
Certification of Grants	We also carry out work to certify the Council's Teachers' Pension return as an audit related non-audit service. Our work on the 2017-18 return is not yet complete and will be finalised by 30 November 2018. We noted some minor amendments to the Council's 2016-17 return (page 9).
Certificate	We are unable to certify that we have completed the audit of the accounts of Warwickshire County Council as we are: <ul style="list-style-type: none">awaiting the receipt of the Pension Fund's Annual Report upon which we are required to issue a 'consistency opinion',finalising our work, having issued provisional views, in respect of two objections received in relation to prior year accounts under sections 26 and 27 of the Act; andat the initial stages of an objection received under sections 26 and 27 of the Act in respect of the 2017/18 financial statements.

We reported the detailed findings from our audit work to the Audit & Standards Committee in our Audit Findings Reports on 25 July 2018. The Council authorised publication of the Statement of Accounts on 26 July 2018.

Respective 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 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 financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Audit of the Accounts

Our audit approach

Working with the authority

We have delivered a number of successful outcomes working alongside you:

- **An efficient audit** – we delivered an efficient audit with you in June and July, delivering the audited accounts before the deadline, releasing your finance team for other work.
- **Sharing our insight** – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports.
- **Providing training** – through our client accountant workshops we provided training opportunities for your teams on financial reporting.

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

Materiality

In our audit of the Council's financial statements (including the Pension Fund), we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating 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.

Authority Materiality

We determined materiality for the audit of the Council's accounts to be £14.351m, which is 1.8% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We set a lower threshold of £0.717m, above which we reported errors to the Audit & Standards Committee in our Audit Findings Report.

We also set a lower level of specific materiality of £100,000 for senior officer remuneration as we considered these disclosures to be sensitive and of specific interest to the reader of the accounts.

Pension Fund Materiality

For the audit of the Warwickshire Pension Fund accounts, we determined materiality to be £19.838 million, 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 threshold of £0.992m above which we reported errors to the Audit & Standards Committee.

We considered the need to set lower levels of materiality for sensitive balances, transactions or disclosure in the accounts, and determined not to set any lower levels.

The scope of our audit

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

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

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

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

Our audit approach is 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 Significant Audit Risks

These are the significant 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
<p>Improper revenue recognition Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. We have rebutted this risk due to nature of the revenue streams within Warw ickshire County Council.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition. • opportunities to manipulate revenue recognition are very limited. • the culture and ethical frameworks of local authorities, including Warw ickshire County Council, mean that all forms of fraud are seen as unacceptable. 	<p>Based on the rebuttal we did not consider this to be a significant risk for Warw ickshire County Council and we identified no issues in respect of revenue recognition in the course of our work.</p>
<p>Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We identified management override of controls as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • gained an understanding of the accounting estimates, judgements applied and decisions made by management and consider their reasonableness • reviewed the journal entry process and the control environment around journal entries • obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness • evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>Our audit work has not identified any evidence of management over-ride of controls. In particular, the findings of our review of journal controls and testing of journal entries has not identified any significant issues.</p>
<p>Valuation of pension fund net liability The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements</p> <p>We identified the valuation of the Council's pension fund net liability as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We also assessed whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement. • evaluated the competence, expertise and objectivity of the actuary who carried out your pension fund valuation. We gained an understanding of the basis on which the valuation was carried out. • undertook procedures to confirm the reasonableness of the actuarial assumptions made. • tested accuracy of data provided to the actuary. • checked the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary. 	<p>Our work has not identified any significant issues in respect of this risk.</p>

Audit of the Accounts

Council Significant Audit Risks (Continued)

These are the significant 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
<p>Valuation of property, plant and equipment The Council revalues its land and buildings on a rolling basis over a five year period to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements.</p> <p>We identified the valuation of land and buildings revaluations and impairments as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> reviewed management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work consideration of the competence, expertise and objectivity of any management experts used. discussions with the valuer about the basis on which the valuation is carried out and challenge of the key assumptions. review and challenge of the information used by the valuer to ensure it is robust and consistent with our understanding. testing of revaluations made during the year to ensure they are 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 has satisfied themselves that these are not materially different to current value. <p>One matter we discussed further with the Council was the carrying value of assets not revalued in the year. The Council holds £100.2m of land and buildings assets which have not been subject to formal valuation in 2017-18. A large proportion of these, £87.3m, were last valued in 2013-14. The Council estimated the potential impact on the carrying value of the assets using indices provided by their internal valuers which indicated a potential understatement in assets valuation of £2.5m. In determining the appropriate indices for use the internal valuers have considered a number of factors including geographic location and asset type (land or building, commercial or residential, smallholdings). We considered:</p> <ul style="list-style-type: none"> the use of the indices used by the Council; and compared these to independent indices provided to Grant Thornton by Gerald Eve, as independent valuers. 	<p>Our work has not identified any significant issues in respect of this risk.</p> <p>Application of the indices provided independently to us by Gerald Eve indicated a potential understatement of £8.8m compared to the Council's £2.5m. This difference was not material and was below our expectation of tolerable error. We were therefore satisfied that the estimate was a result of applying an appropriate estimation technique and were not minded to challenge the Council's estimate as being unreasonable.</p> <p>The Council's entire asset base (excluding schools) will be revalued in 2018/19 in line with its five year revaluation policy.</p>
<p>Implementation of new payroll system Payroll expenditure represents a significant percentage (35%) of the Council's operating expenses. The Council rolled out a new payroll system during 2017/18.</p> <p>As a key change to a material financial system we determined we needed to ensure we obtained sufficient assurance on the effective operation of the system throughout 2017/18</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> documented our understanding of the processes and key controls for payroll. documented our understanding of the management of the changeover process. reviewed monthly payroll figures produced by the payroll system in the periods before and after the date of changeover and investigation of any significant variances. performed analytical procedures on the total payroll figures for 2017/18. 	<p>Our work has not identified any significant issues in respect of this risk.</p>

Audit of the Accounts

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>The revenue cycle includes fraudulent transactions</p> <p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Pension Fund, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition. • opportunities to manipulate revenue recognition are very limited. • the culture and ethical frameworks of local authorities, including Warwickshire County Council as the Administering Authority of Warwickshire Pension Fund, mean that all forms of fraud are seen as unacceptable. 	<p>Based on the rebuttal we did not consider this to be a significant risk for Warwickshire Pension Fund and we identified no issues in respect of revenue recognition in the course of our work.</p>
<p>Management override of controls</p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness. • documented the journal control environment, obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness. • evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.</p>

Audit of the Accounts

Pension Fund Significant Audit Risks (Continued)

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>The valuation of Level 3 investments is incorrect</p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p> <p>We identified the valuation of level 3 investments as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> gained an understanding of the Fund's process for valuing level 3 investments and evaluated the design of the associated controls. reviewed the nature and basis of estimated values and considered what assurance management had over the year end valuations provided for these types of investments. considered the competence, expertise, qualifications and objectivity of fund managers used as management experts used to value Level 3 investments at year end. requested year-end confirmations from fund managers and custodians of all holdings and valuations at the period end together with a statement of transactions (including purchases, sales and investment income if possible) during the period. ensured confirmations from fund managers and custodians tied back to the accounts, and investigated any non-trivial variances. reviewed investment manager service auditor reports on operating effectiveness of internal controls. for all level 3 investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciled those values to the values at 31 March 2018 with reference to known movements in the intervening period. 	<p>Our audit work did not identify any significant issues in respect of level 3 investments.</p> <p>However, as noted the valuations of these investments are subject to a degree of judgment 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 for investments held with Harbourvest was £1.8m more than that reported by the custodian. The difference has been investigated and is not material to the fund. The difference can be explained as a result of differing estimation techniques between the fund manager and the custodian and timing differences. We are therefore satisfied that the estimate is a result of applying an appropriate estimation technique and no amendment is required to the accounts</p> <p>In addition, we have 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 have again noted that a review of the accounts suggests a valuation of £84.4m when compared to the custodian value of £78.1m, a difference of £6.2m. This difference is not material and is below our expectation of tolerable error. We are therefore satisfied that the estimate is a result of applying an appropriate estimation technique and no amendment is required to the accounts.</p>

Audit of the Accounts

Audit opinion

We gave an unqualified opinion on both the Council's financial statements the Warwickshire Pension Fund accounts on 27 July 2018, in advance of the national deadline.

Preparation of the accounts

The Council and Pension Fund presented us with draft accounts in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audits.

Issues arising from the audit of the accounts

We reported the key issues from our audits to the Council's Audit & Standards Committee in our Audit Findings reports on 25 July 2018.

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 [in and/or alongside the Statement of Accounts] in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement which noted the minor amendments made by the Council and did not identify any issues for the group auditor to consider on 8 August 2018.

Certificate of closure of the audit

We are unable to certify that we have completed the audit of the accounts of Warwickshire County Council as we are:

- awaiting the receipt of the Pension Fund's Annual Report upon which we are required to issue a 'consistency opinion',
- finalising our work, having issued provisional views, in respect of two objections received in relation to prior year accounts under sections 26 and 27 of the Act; and
- at the initial stages of an objection received under sections 26 and 27 of the Act in respect of the 2017/18 financial statements.

Certification of 2016-17 Certification of Teachers Pension return

As noted in Appendix A, since our last Annual Audit Letter we have provided non-audit services in respect of certifying the Council's 2016-17 Teachers Pension return. We identified some very minor amendments in respect of the classification of Career Average Flexibilities and elections of additional pension payments which were included in our report to Teachers' Pensions dated 29 November 2017.

Value for Money conclusion

Background and key findings

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 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.* 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 below.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Financial sustainability The Council has a "One Organisation Plan 2017-2020" in place which identified the need to make significant savings. The Council has a good track record of savings delivery for the previous One Organisational Plan 2014-2018 but the update to 2020 in 2017 identified the need for a further £67m of savings by 2020.</p>	<p>We reviewed:</p> <ul style="list-style-type: none"> 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 2018/19 budgets progress made in identification and agreement of plans to deliver savings of £67m by 2020 outturn against the plan for 2017/18 and progress made in 2018/19 by the date of the issue of our opinion. <p>We considered the Council's internal financial reporting and noted that committee reports report quarterly against the revised budget position, which is considered good practice. We note the Council's recent introduction of monthly finance and performance dashboards, which include the original baseline budget, as an improvement to the clarity of reporting. The Council should consider extending this to the revenue and capital reporting as part of its annual reporting process.</p>	<ul style="list-style-type: none"> The Council continued its strong historical record in financial control by delivering services within budget in 2017/18 and set a balanced budget for 2018-19 in line with requirements. The Council's General Fund reserve remains healthy. At the start of 2017/18 the Council held reserves of £133.395 million. With the approved in-year use of reserves and the effect of outturn, reserves increased to £146.801 million. The Council has reviewed the level of reserves and considers that they are consistent with Business Units/Directorates plans for managing the financial risks and demands facing services over the next two years. At the end of 2018/19 General Reserves are expected to be £27.273 million. This is £8.773 million above the £18.500 million minimum specified by the Head of Finance in his risk assessment when the 2018/19 budget was set. The Council is currently maintaining an over borrowed position. This means there is no current need for capital borrowing (the Capital Financing Requirement). Based on the estimates of medium term capital expenditure, the Council's gross borrowing covers the Capital Financing Requirement until 2020/21. The Council reported achieving savings of £29.225 million (91.5%), against the Authority's 2017/18 target of £31.935 million. The shortfall is now forecast to be delivered by the end of the OOP 2020. The outturn against plan was an under-spend against revenue budgets in 2017/18 of £8.359 million (3.3%). The Council is reporting that it is on-track with its 2018-19 budget plan as at month 2 with income in line with budget and expenditure below budget profile. <p>Overall our work concluded that the Council has appropriate arrangements for delivering economy, efficiency and effectiveness. The Council's overall financial position remains challenging, given the level of savings that it needs to find in order to set balanced budgets in future years. We recommended that the Council should consider extending reporting against baseline budget to both revenue and capital reporting as part of its annual reporting process.</p>

Overall Value for Money conclusion

We are 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 2018.

A. Reports issued and fees

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

Reports issued

Report	Date issued
Audit Plan	March 2018
Audit Findings Report	25 July 2018
Annual Audit Letter	August 2018

Audit Fees

	2017/18 Planned £	2017/18 Actual fees £	2016/17 Actual fees £
Statutory Council audit	£94,539	£94,539	£94,539
Audit of Pension Fund	£23,892	£23,892	£23,892
IAS 19 Assurance to Other Auditors	TBC	£1,328	£1,328
Total fees	[TBC]	£119,759	£119,759

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA). The IAS 19 Assurance Fees cannot be easily predicted as it is linked to the number of requests received. There were no significant changes in requests received in 2017/18.

Note 31 in Section B – Page 39 of the Statement of Accounts shows external audit costs of £0.1m (£94,539 and the £4,200 of non-audit services) and Note 14 in Section D – Page 19 within the Pension Fund Section of the Statement of Accounts reflects the £25,220 paid for pension fund audit fees.

Fees for non-audit services provided in 2017/18

Service	Fees £
Audit related services	£4,200
Certification of the 2016/17 Teachers Pension return (undertaken November 2017)	
Non-Audit related services	NIL Cash Received in Year
- CFO Insights*	
* A £30,000 payment 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..	

Non-audit services

- 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 non-audit services which were identified.
- We have considered whether non-audit 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.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.



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