

Colchester Borough Council

Annual Audit Letter for the year ended 31 March 2015

October 2015

Ernst & Young LLP



Building a better
working world

Members
Colchester Borough Council
Rowan House
33 Sheepen Road
Colchester
CO3 3WG

8 October 2015

Dear Members

Annual Audit Letter 2014-15

The purpose of this annual audit letter is to communicate the key issues arising from our work to the Members and external stakeholders, including members of the public.

We have already reported the detailed findings from our audit work in our 2014-15 Audit Results Report to the 8 September 2015 Governance Committee, representing those charged with governance. We do not repeat them here.

The matters reported here are those we consider most significant for Colchester Borough Council.

We would like to take this opportunity to thank officers for their assistance during the course of our work.

Yours faithfully

Debbie Hanson
Director
For and on behalf of Ernst & Young LLP
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Relevant parts of the Audit Commission Act 1998 are transitionally saved by the Local Audit and Accountability Act 2014 (Commencement No. 7, Transitional Provisions and Savings) Order 2015 for 2014/15 audits.

The Audit Commission's 'Statement of responsibilities of auditors and audited bodies' (Statement of responsibilities). It is available from the accountable officer of each audited body and via the [Audit Commission's website](#).

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's 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 Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (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.

1. Executive summary

Our 2014-15 audit work was undertaken in accordance with the Audit Plan issued on 16 June 2015 and was conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

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 having proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As auditors we are responsible for:

- forming an opinion on the financial statements, and on the consistency of other information published with them
- reviewing and reporting by exception on the Council's AGS
- forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources
- undertaking any other work specified by the Audit Commission and the Code of Audit Practice.

Summarised below are the results of our work across all these areas:

Area of work	Result
Audit of the financial statement of Colchester Borough Council for the financial year ended 31 March 2015 in accordance with International Standards on Auditing (UK & Ireland)	On 17 September 2015 we issued an unqualified audit opinion on the Council's financial statements
Form a conclusion on the arrangements the Council has made for securing economy, efficiency and effectiveness in its use of resources	On 17 September 2015 we issued an unqualified value for money conclusion
Report to the National Audit Office on the accuracy of the consolidation pack the Council needs to prepare for the 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.
Consider the completeness of disclosures on the Council's AGS, identify any inconsistencies with other information which we know about from our work and consider whether it complies with CIPFA/ SOLACE guidance	No issues to report
Consider whether we should make a report in the public interest on any matter coming to our notice in the course of the audit	No issues to report
Determine whether we need to take any other action in relation to our responsibilities under the Audit Commission Act	No issues to report

As a result of the above we have also:

Issued a report to those charged with governance of the Council with the significant findings from our audit.

Our Audit Results Report was presented to the Governance committee on 8 September 2015

Issued a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission.

We issued our certificate on 17 September 2015

In January 2016 we will also issue a report to those charged with governance of the Council summarising the certification (of grant claims and returns) work we have undertaken

2. Key findings

2.1 Financial statement audit

The Council's Statement of Accounts is an important tool to show both how the Council 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 Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission and issued an unqualified audit report on 17 September 2015.

Our detailed findings were reported to the 8 September Governance Committee.

In our view, the quality of the process for producing the accounts, including the supporting working papers was good.

The main issues identified as part of our audit were:

Significant risk 1: Risk of management override

As identified in ISA (UK and Ireland) 240, 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. We identify and respond to this fraud risk on every audit engagement.

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 designed and performed appropriate audit procedures to obtain reasonable assurance that the financial statements as a whole are free of material misstatement.

Findings:

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- ▶ We did not identify any material misstatements, evidence of management bias or significant unusual transactions in our testing of journals and estimates.
 - ▶ Our testing to identify any expenditure which had been inappropriately capitalised did not identify any expenditure which should have been disclosed as revenue.
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Significant risk 2: Non domestic rates appeals provision

Following the localisation of business rates in 2013 the Council is now responsible for paying rating appeals. This not only includes claims from 1 April 2013 but also claims that relate to earlier periods. As appeals are made to the valuation office the Council may find it difficult to obtain sufficient information to establish an appropriate estimate. 2014-15 is the second year for which the Council has assumed this liability and has therefore had to calculate an associated provision. A cut off applied at the 31 March 2015 for the submission of any backdated appeals, along with some settlements during 2014-15 which were significantly in excess of the amount the Council provided for in 2013-14, means that there remains a significant risk around this estimate.

We designed and performed appropriate procedures to obtain sufficient assurance that:

- ▶ The Council's provision for business rate appeals was calculated on a reasonable basis in line with IAS37.
 - ▶ The provision was supported by appropriate evidence and the level of estimation uncertainty was adequately disclosed in the accounts.
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- ▶ We could rely on the management expert appointed by the Council to determine the likely level of appeals, which supports the provision in the accounts.

Findings:

The business rates appeals provision accounted for by the Council was deemed to have been calculated on a reasonable basis in line with the requirements of IAS 37. The level of estimation uncertainty was adequately disclosed in the accounts.

2.2 Value for money conclusion

As part of our work we must also conclude whether the Council has proper arrangements to secure economy, efficiency and effectiveness in the use of resources. This is known as our value for money conclusion.

In accordance with guidance issued by the Audit Commission, our 2014-15 value for money conclusion was based on two criteria. We consider whether the Council had proper arrangements in place for:

- ▶ securing financial resilience, and
- ▶ challenging how it secures economy, efficiency and effectiveness.

We issued an unqualified value for money conclusion on 17 September 2015.

We noted the following as part of our audit.

Arrangements to secure financial resilience

We identified a significant risk relation to the level of reliance placed on funding from the New Homes Bonus (NHB) in the Council's medium term financial strategy (MTFS). This has also been identified as a risk in a number of other councils which receive significant levels of funding through the NHB, where this has been built into the base budget.

To address this risk, we have undertaken a more detailed review of the Council's MTFS and the key assumptions within this, including the planned use of NHB. We have also looked at the level and planned use of reserves and the Council's track record in delivering previous budgets and savings plans, as well as progress on addressing the budget gaps identified in the current MTFS.

Findings

The Council has continued to respond well to the financial challenges it is facing and has a strong track record of delivering its budget and planned savings. The 2014-15 budget included around £2.7 million of savings or additional income, which were successfully delivered. In both 2013-14 and 2014-15 the Council reported an underspend against budget of around £0.3 million. This consistent performance indicates that the Council has a good system of budgetary control.

In the MTFS issued in January 2015, the Council identified a cumulative budget gap of £1.68 million over the next three years, with a balanced budget for 2015-16. The MTFS update in July 2015 reduced this cumulative gap to £1.58 million. This appears to be a relatively manageable budget gap compared to the Council's gross expenditure in 2014-15 of £130 million. The Council continues to identify savings and income generation opportunities to address this gap and senior managers are confident that they have already identified ways in which the gap of £0.5 million in 2016-17 can be met.

The MTFS is based on a number of assumptions, including estimates of the future levels of Government funding. NHB of around £13.1 million has been included over the period 2015-16 to 2017-18, of which £5.8 million has been used to fund the base budget of ongoing spend.

Any reduction of the NHB, or any other Government funding source in future years, would present a risk to achievement of the Council's future budgets.

The Council clearly recognises the risks in relation to the uncertainty of future Government funding and in particular the NHB. The budget strategy assumes that any growth in the NHB will be allocated to new one-off projects. This reflects the aim of minimising the risk of reductions in levels of NHB funding. However at present, around £2 million of NHB per year is included in the MTFS to support the base budget. This is around 43% of the total NHB funding received.

The MTFS also assumes that the fixed support element of Government funding through RSG and NDR (business rates) will continue to reduce in future years broadly in line with the reductions experienced in recent years. However the actual level of reduction could be greater than this.

The Council holds adequate levels of reserves. At the end of 2015, the level of General Fund balances was £9.6 million. Of this £5.4 million is forecast to be spent or to be allocated during 2015-16, and a further £1.9 million is allocated for future year costs or against specific risks. This leaves £2.3 million uncommitted or unallocated. This is £0.5 million above the recommended minimal level of £1.8 million set by the Strategic Finance Manager. In addition to the general fund balance, the Council also has earmarked reserves of £10.38 million.

On this basis of our work we have undertaken we have concluded that the Council's arrangements to secure financial resilience are adequate.

2.3 Whole of Government Accounts

We performed the procedures required by the National Audit Office. The Council is below the specified audit threshold of £350million and therefore we are not required to audit the accuracy of the consolidation pack.

2.4 Annual Governance Statement

We are required to consider the completeness of disclosures in the Councils AGS, identify any inconsistencies with the other information which we know about from our work, and consider whether it complies with relevant guidance.

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

2.5 Objections received

We did not receive any objections to the 2014-15 financial statements from members of the Public.

2.6 Other powers and duties

We did not identify any issues during our audit that required us to use powers under the Audit Commission Act 1998, including reporting in the public interest.

2.7 Independence

We communicated our assessment of independence to the Governance Committee on 8 September. In our professional judgement the firm is independent and the objectivity of the audit engagement director and audit staff has not been compromised within the meaning of regulatory and professional requirements

2.8 Certification of grant claims and returns

We have not yet completed our work on the certification of claims and returns. We will issue the Annual Certification report for 2014-15 in January 2016.

3. Control themes and observations

As part of our work, we obtained enough understanding of internal control to plan our audit and determine the nature, timing and extent of testing performed. We have not tested the individual system controls of the Council as we have adopted a fully substantive approach to our audit.

Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to tell the Council about any significant deficiencies in internal control we find during our audit.

We did not identify any significant deficiencies in the design of an internal control that might result in a material misstatement in the Council's financial statements.

4. Looking ahead

There are a number of changes in accounting and auditing requirements that could have a significant impact on the Council's arrangements for the production of its financial statements. We have outlined what we think are two of the main challenges below.

Description	Impact
<p>Highways Network Asset (formerly Transport Infrastructure Assets):</p> <p>The Invitation to Comment on the Code of Accounting Practice for 2016-17 sets out the requirements to account for Highways Network Asset under Depreciated Replacement Cost. This is a change from the existing requirement to account for these assets under Depreciated Historic Cost. This change is to be effective from 1 April 2016.</p> <p>This requirement is not only applicable to highways authorities, but to any local government bodies that have assets which fall into the definition. This could include, for example, footways and cycle ways, housing revenue accounts (HRA) infrastructure, unadopted roads on industrial or HRA estates, and street furniture.</p> <p>This may be a material change of accounting policy for the Council. It could also require changes to existing asset management systems and valuation procedures.</p>	<p>The Council should consider whether it holds any assets that would be classified as highways network assets and, if so, whether they have the necessary information to implement the changes in accounting for these assets from 1 April 2016.</p> <p>If the impact of this change in accounting policy is material, the Council would also need to restate the balances for these assets as at 1 April 2015.</p>
<p>Earlier deadline for production and audit of the financial statements from 2017-18</p> <p>The Accounts and Audit Regulations Accounts and Audit Regulations 2015 were laid before Parliament in February 2015. A key change in the regulations is that from the 2017-18 financial year the timetable for the preparation and approval of accounts will be brought forward.</p> <p>As a result, the Council will need to produce draft accounts by 31 May and these accounts will need to be audited by 31 July.</p>	<p>These changes provide challenges for both the preparers and the auditors of the financial statements.</p> <p>The Council is aware of this challenge and the need to start planning for the impact of these changes. This will necessarily include review of the processes for the production and audit of the accounts, including areas such as the production of estimates, particularly in relation to pensions and the valuation of assets, and the year end closure processes.</p>

5. Fees

Our fee for 2014-15 has been amended from the scale fee set by the Audit Commission and reported in our Audit Results Report presented on 8 September 2015

	Final fee 2014-15	Scale fee 2014-15
Total Audit Fee – Code work	£83,113	£80,443
Total Audit Fee – Certification of claims and returns	£19,690	£19,690

We have incurred additional audit time in performing direct testing procedures to gain assurance over the figures from Colchester Borough Homes (CBH) for the purposes of issuing our opinion on the group accounts. We performed direct testing on material balances as we assessed this to be the most efficient approach for our audit. The alternative would have been to issue component auditor instructions to the auditors of CBH and review a sample of their work to confirm we could place reliance on it. The additional fee for this work is £2,670. This has been agreed with the Finance Manager (Technical), and will also need to be agreed by PSAA.

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