

St Albans City & District Council

Annual Audit Letter for the year ended 31 March 2015

October 2015

Ernst & Young LLP



Building a better
working world



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19 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 Members and external stakeholders, including members of the public.

We reported the detailed findings from our audit work in our 2014-15 Audit Results Report. This was presented to the Audit Committee, representing those charged with governance, on 29 September 2015. The matters reported here are those we consider most significant for St Albans City & District Council.

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

Yours faithfully

Neil Harris
Executive 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 our Audit Plan issued in March 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 St Albans City & District Council for the financial year ended 31 March 2015 in accordance with International Standards on Auditing (UK & Ireland)	On 29 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 29 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	We have 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	We have no issues to report.
Determine whether we need to take any other action in relation to our responsibilities under the Audit Commission Act	We have 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 Audit and Standards committee on 29 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 29 September 2015.

In December 2015 we will 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. We issued an unqualified audit report on 29 September 2015.

Our detailed findings were reported to the Audit and Standards Committee on 29 September. Our audit work on the Council's financial statements identified a number of amendments to the disclosures made within the financial statements. The following are the most significant.

- ▶ Comparative amounts for the prior year were restated to reflect a change in accounting policy with regard to the write-out of capital expenditure that that did not add to the value of the underlying asset. An additional note was also added to the financial statements to explain the basis of the change.
- ▶ Further disclosure was provided on the effects of a change in the basis on which depreciation charges were calculated.
- ▶ Disclosures in relation to Related Party Transactions were amended to include asset transferred to related parties.
- ▶ Disclosure around estimation uncertainty inherent in the calculation of provisions recognised to reflect future losses arising from appeals against the rateable value of commercial properties.
- ▶ A misclassification error between current and non-current liabilities was identified. This misstatement was corrected. This adjustment had no impact on the Council's net assets, or its useable reserves.

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 or unusual transactions in our testing of journals and estimates.
 - ▶ We did not identify any instances of expenditure being incorrectly classified between revenue and capital
-

Significant risk 2: Property asset valuation and accounting

The Council holds a significant number of property assets. The valuation of these assets represents a significant accounting estimate. The accounting entries arising from changes in value are complex and will have a significant impact on the Council's financial statements.

Findings:

- ▶ We assessed the reliability of the work management's experts, validating their work against information provided to us by our own valuation specialists. We concluded we could place reliance on the work undertaken by management's expert.
 - ▶ We concluded that the evidence available to support the valuation of property, plant and equipment was sufficient and reliable, and that changes in the value of those assets had been correctly reflected in the Council's accounting systems and financial statements.
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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 29 September 2015.

Arrangements to secure financial resilience: significant risk

Identified risk - Along with many other Council's, St Albans City & District Council is facing significant financial challenges over the next three to four years. The Council's external funding sources are reducing and are likely to be subject to change and uncertainty in future years.

We reviewed the Council's response to the challenges it faces, including the plans it has in place to address budget gaps, and the assumptions and scenario planning undertaken as part of its long term financial planning.

The Council's 10 year budget forecast identifies a cumulative budget gap over the period 2016/17 - 2017/18 of £1.5 million. This gap assumes the Council will continue to receive funding from the New Homes Bonus of approximately £3 million per annum. While there is currently no indication that central government will cease or reduce New Homes Bonus, reliance on this uncertain funding stream does, however, represent a risk to the financial resilience of the Council. Were this funding to cease, the Council's budget gap over the period to 2015-16 - 2016-17 would rise to £4.5 million.

We have assessed that the level of general fund reserves (both general and earmarked) available to the Council (after allowing for minimum reserve levels) total £3.1million. Assuming funding from the New Homes Bonus continues at the level assumed by the Council, these cover the budget gap identified in the Council's 10 year budget forecast. However, the size of the Council's overall level of reserves are lower than similar sized Councils, and leave it limited scope to meet unexpected financial pressures.

In our view the challenge faced by the Council is considerable, and there are a number of uncertainties that could yet have a significant impact on future financial stability of the Council, not least the upcoming Autumn 2015 Spending Review. We identified the following actions for the Council:

- ▶ The Council does not prepare and publish a Medium Term Financial Strategy, although the key components of a strategy are prepared and presented annually to Members as part of the Council's budget setting process. We consider combining these into a comprehensive, standalone document that draws together all of the factors impacting on the Council's financial position would improve both governance and scrutiny over financial resilience.
- ▶ Many of the Council's Earmarked reserves have been held for a number of years, with few sums transferred into, or out of, those reserves. Included within these were 'Other' Earmarked Reserves of £689,000 comprises 38 separate reserves with a value ranging from £256 to £81,360. We consider that there is a need for the Council to review and assess whether there is a continued need to hold these reserves and, where there isn't, return those reserves to general reserves. The Council should also develop a clear policy on the use of earmarked reserves, setting out the approval processes for both the creation of, and use of, these reserves.

2.3 Whole of Government Accounts

The assets and liabilities held by the Council, and its income and expenditure, are below the specified audit threshold of £350 million. Therefore we were not required to audit the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

2.4 Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's 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 and Questions from Members of the Public

We did not receive any objections to the 2014-15 financial statements from members of the public. Following publication of the draft financial statements by the Council, we did however, receive correspondence from a member of the public setting out an intention to object to the Council's draft financial statements. The basis of that objection was:

- ▶ the need to improve the clarity of disclosures within the financial statements, in particular around the narrative accompanying numerical the numerical disclosures within the Explanatory Foreword,
- ▶ the absence of explanations for significant year-on-year variances; and
- ▶ the completeness of disclosures in relation to related parties.

We agreed with the member of the public and the Council that rather than treat this as a formal objection to the accounts at the time, steps would be taken by the Council's finance team to respond to each of the individual points and where appropriate revisions to the draft financial statements. This process was concluded in September 2015, with the production of written responses, revised financial statements and concluding discussions. A number of the matters referred to in Section 2 of our letter arose from this process.

We also received correspondence that contended income received by the Council from enforcement action taken in relation to certain controlled parking zones was ultra vires. This was because restrictions giving rise to the enforcement action had not been adequately made known to motorists by means of appropriate traffic signs.

We were satisfied that the Council acted properly in responding to this matter. Steps taken by the Council included taking legal advice, and suspending the Order giving effect to the parking restrictions. The income received by the Council in 2014-15 until suspension of the Order was approximately £3,000. In our view it is likely the Courts would conclude that the Order, and enforcement action taken by the Council in relation to that Order, was unlawful. However, given the relatively small value of the amounts involved, we did not consider it cost effective or proportionate to seek a declaration to the Courts on this matter.

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 Audit Committee on 29 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 the claims and returns. We will issue our Annual Certification report for 2014-15 in December 2015.

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. The matters reported are shown below. We have listed only the deficiencies we found during the audit which we think it is important to bring to your attention.

Description	Impact
<p>The Council has engaged a third party to assist it in estimating the likely impact of appeals lodged with the Valuation Office against the rateable value of business premises.</p> <p>In testing this estimate, we sought information to support the judgements made in calculating the estimate, and evidence underlying calculation of the estimate. Responses to our requests were piecemeal as the Council did not have a clear understanding of the methodology applied by the third party, or easy access to the data used in calculation of the estimate.</p>	<p>Without a clear understanding of the work undertaken on its behalf by third parties, the Council is unable to sufficiently review and validate its provision for business rate appeals.</p> <p>It also led to delays in our completing our testing of this significant estimate.</p>
<p>Our testing of expenditure reported within the Comprehensive Income and Expenditure Statement included a number of payments relating to refuse collection. In testing this expenditure, we sought to confirm the value of the payment against the underlying contract. However, the Council were unable to provide us with an up to date payment schedule from the contract that provided evidence of the amounts due.</p>	<p>While we were able to obtain the evidence necessary to support our audit opinion through other means (including reconciliation to the overall contract value reported to Members at the point the contract was let) without access to an up to date payment schedule, it is unclear how officers have confirmed that claims for payment submitted by the Council's contractor are accurate in advance of those claims being authorised for payment.</p>

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 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

A breakdown of our fee is shown below.

	Proposed final fee 2014/15 £'000	Planned fee 2014/15 £'000	Scale fee 2014/15 £'000
Total Audit Fee – Code work	87,045	80,045	80,045
Certification of claims and returns	33,840	33,840	33,840

Our final fee for 2014/15 includes a proposed variation to the scale fee of £7,000. During 2014/15 we have considered a number of matters that represent a change in the scope of our audit and fall outside of the scale fee. These include:

- ▶ Our consideration of correspondence from the public in relation to car parking income, and formal objections received in relation to the financial statements.
- ▶ Our consideration of the effects of the change in accounting policy in relation to the write-off of assets not adding to value, and the testing of subsequent amendments to the financial statements.
- ▶ Our consideration of the change in estimation techniques proposed by management in relation to the componentisation and depreciation of council dwellings.
- ▶ The additional work we undertook to assure ourselves of the accuracy of the Council's provision for appeals against the rateable value of commercial properties.

The proposed variation to the scale fee is subject to approval by Public Sector Audit Appointments Limited.

Our work on the certification of grant claims is currently in progress. Our final fee for this work will be included within our Annual Certification Report for 2014 /15. This will be reported to those charged with governance in January 2016.

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