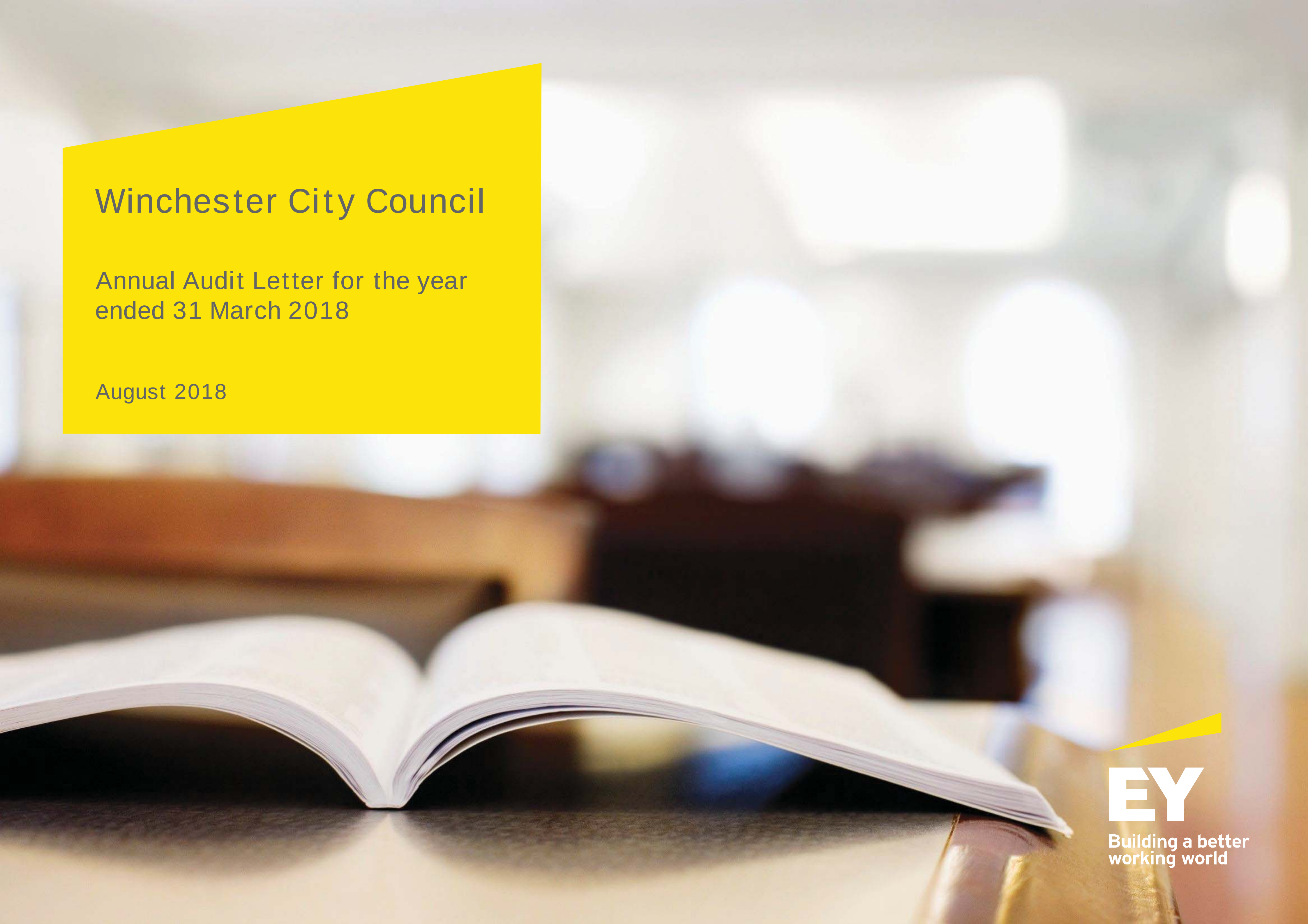
Winchester City Council

Annual Audit Letter for the year ended 31 March 2018

August 2018



Building a better working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a ‘Statement of responsibilities of auditors and audited bodies’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment (updated 23 February 2017)’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to Winchester City Council (the Council) following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 26 July 2018 and presented to the Audit Committee on 31 July 2018.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 31 July 2018.

In November 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken on the Council's Housing Benefit claim.

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

Helen Thompson

Associate Partner

For and on behalf of Ernst & Young LLP

02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the 31 July 2018 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued on 8 March 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2017/18 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £500 million. Therefore we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

03 Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2018.

Our detailed findings were reported to the 31 July 2018 Audit Committee.

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

Significant Risk	Conclusion
Misstatements due to fraud or error 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.	To gain assurance we: • Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. • Reviewed accounting estimates for evidence of management bias, including estimates with a higher level of inherent risk relating to PPE and the pension liability. • Considered the appropriateness of any changes to accounting policies particularly those impacting on accounting estimates. • Considered entries made in the Movement in Reserves Statement (MIRS) which impact on the Council's reported reserves. • Evaluated the business rationale for significant unusual transactions. We identified no material weaknesses in controls or evidence of material management override based on our work.

Financial Statement Audit (cont'd)

The other areas of audit focus identified as part of our audit were as follows:

Area of Audit Focus	Conclusion
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	The procedures we undertook were to: • Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work. • Sample test key asset information used by the valuers in performing their valuation (for example floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer. • Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE and annually for Investment Property. Review assets not subject to valuation in 2017/18 to confirm that the remaining asset base is not materially misstated; and • Test to confirm that accounting entries have been correctly processed in the financial statements. We identified one issue as a result of our work. We found that the depreciation charge for council dwellings was based on an estimated useful life of 150 years for the structural element of buildings. Following our challenge, this was revised by the Council, based on the advice of its valuer, to 80 years which we considered to be reasonable, although it is at the upper end of our expectations. The Council had also not initially removed the value of land, which is not subject to revaluation, from its calculation of Housing Revenue Account (HRA) depreciation. The combined impact of these adjustments, which offset against each other, resulted in a trivial impact on the overall council dwelling depreciation charge. Given the trivial impact of the error no adjustment has been made to the depreciation charge in the financial statements.
Restatement of Comprehensive Income and Expenditure Statement (CIES) and Expenditure and Funding Analysis (EFA) Restructuring of services undertaken in the period and changes to its internal financial reporting required the Council to re-analyse, re-present and re-state the portfolio analysis of its service level income and expenditure disclosed in the CIES and other related disclosures in its financial statements.	The procedures we undertook were to: • Agree the restated comparative figures back to the Council's prior year financial statements and supporting working papers; • Review the CIES, EFA and supporting notes to ensure disclosures are in line with the Code; and • Review the analysis of how these figures are derived, how the ledger system has been re-mapped to reflect the Council's organisational structure and how overheads are apportioned across the service areas reported. We identified no issues as a result of our work.

Financial Statement Audit (cont'd)

Area of Audit Focus	Conclusion
Pension Asset/Liability Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2017, the most recent available information at the time our audit planning work was undertaken, this totalled £56.4 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	To gain assurance we: • Liaised with the auditors of Hampshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Winchester City Council. • Assessed the work of the Pension Fund actuary (Aon Hewitt) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team. • Reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. We had one finding from our review of available outturn information. For timing reasons, the actuary estimates the value of the pension fund assets at 31 March. This estimate varied by approximately £31 million from the actual fund value as at 31 March. The Council's estimated share of this variance is £535,000, which is not material but above our reporting threshold. Management decided not to adjust the accounts for this non-material variance. The Audit Committee approved this approach and an explanation for not making an adjustment was provided by management in the letter of representation.

Financial Statement Audit (cont'd)

Our application of materiality

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

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £1.899 million (2016/17 £1.824 million), which is 2% of gross revenue expenditure reported in the accounts adjusted for the exceptional item disclosed in respect of HRA revaluation. We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.424 million (2016/17: £1.368 million).

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. We considered both the qualitative impact and aggregate value of uncorrected misstatements and agreed with management's assessment that they did not have a material impact.

04 Value for Money

Value for Money

We are required to consider whether the Council has put in place ‘proper arrangements’ to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

We did not identify any significant risks in relation to these criteria. We noted, however, that we would continue to review the development of contract management and procurement arrangements in response to issues raised as part of our 2016/17 VFM conclusion work. We also undertook to consider the ongoing work at the Council to modernise and improve organisational governance more generally.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council’s arrangements.

Value for Money (cont'd)

We therefore issued an unqualified value for money conclusion on 31 July 2018.

Area of focus	Conclusion
Year-end financial position and future financial plans	The Council performed well against the targets it set for itself in the 2017/18 budget. In terms of General Fund revenue performance, the Council underspent against budget by approximately £1.8 million including funding & investment activity, baseline net expenditure, and reserves and other adjustments. Total General Fund reserves (including the General Fund balance) increased by around £3 million. The final surplus after transfers to and from earmarked reserves of approximately £0.8 million was transferred to the General Fund balance. A small surplus was also delivered against the Housing Revenue Account (HRA) revenue budget with the Council reporting an outturn surplus of £118,000 which was added to the HRA working balance, against a budgeted deficit for the year of approximately £2.3 million. There remains, however, a relatively high level of slippage in the General Fund capital programme budget and, to a lesser extent, the HRA capital programme budgets. The Council continues to have a high value and ambitious capital programme relative to its size. Although the Council is not heavily reliant on the delivery of the capital programme to generate revenue benefits needed to help balance the budget over the medium term, it does recognise that arrangements in this area need to continue to be developed and improved with project governance and reporting recognised as a significant governance issue in its year end Annual Governance Statement. The Council last reported an update of its Medium Term Financial Strategy (MTFS) in February 2018. This showed that the previously reported budget gap for 2018/19 has now been closed. However the MTFS shows a small budget gap from 2019/20 with a sharp increase to £4.3 million from 2020/21. The Council has a good track record of closing the budget gap annually and has actually added to available reserves over the last three years. We therefore currently have no significant concerns over the Council's financial resilience. It is however important that good financial discipline is maintained to help mitigate the potential impact of risks and uncertainties faced over the medium term. The introduction of financial and performance quarterly monitoring during the year has brought a greater level of accountability and clarity for members, officers and the wider public on the financial and overall performance of the Council on an in-year basis. Given the level of financial challenge and uncertainty faced by Local Government generally, and the Council specifically, this is a necessary improvement to arrangements. In particular it will assist the Council in being able to better assess the efficacy of the actions to secure savings in a timely manner as it seeks to continue to close the medium term budget gap it faces.
Developments in contract management and procurement arrangements	As part our 2016/17 audit results report we highlighted specific weaknesses in contract management arrangements for the Council's main Leisure and Environmental Services contracts. As part of our work we considered the following relevant developments during the year and up to the date of audit: • Re-negotiation of the waste collection contract with East Hampshire District Council • An Internal Audit review of procurement with an overall conclusion of adequate assurance. • The current operator procurement exercise for outsourced leisure services. We are satisfied that progress is being made to address the previously identified issues. There is however a clear recognition that this area remains a work in progress and a separate Internal Audit review of high level arrangements for working in partnership arrived at a 'limited assurance' conclusion. The Council recognises that some of the partnership audit weaknesses identified by the review feed into contract management which it has assessed as being a much greater strategic risk, and which features as a significant governance issue in its 2017/18 Annual Governance Statement.

Value for Money (cont’d)

Area of focus	Conclusion
Developments in organisation governance arrangements	At the planning stage we noted that we would consider the ongoing work at the Council to modernise and improve organisational governance more generally building on the Local Government Association (LGA) Peer review undertaken in 2016/17 and the independent review of Silver Hill carried out in 2015/16. A Peer Review follow-up had been planned to be delivered by the LGA in June 2018 but this has been delayed. We have therefore considered Internal Audit work to follow-up progress made against recommendations arising from both the LGA and Silver Hill reviews. Based on the Internal Audit work undertaken at February 2018, good progress is being made in addressing the recommendations arising from both the 2016/17 LGA Peer Review and the independent review of Silver Hill that preceded it. There is only one remaining ‘red’ rated recommendation for progress on implementation across both reviews with the majority of recommendations having ‘green’ status for implementation. However, major work to fully review and refresh the Council’s Constitution remains ongoing and it is important the Council retains a continued focused on the modernisation and development of governance arrangements at an organisational level to promote greater flexibility and responsiveness of decision making.

05 Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

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

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 31 July 2018. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

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

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

Our audit did not identify any significant deficiencies in internal control. We did, however, bring one issue to the attention of the Audit Committee.

As part of our work we are required to obtain and read significant contracts, agreements, and similar documents and consider their accounting or auditing implications. In undertaking this work we identified that the Council's on-line contract register accessible via its website was not fully complete and up to date. It is important that this is addressed and we noted that the Council itself discloses a significant governance issue in its 2017/18 Annual Governance Statement around the need to disclose a comprehensive contracts register.

06 Data Analytics

Use of Data Analytics in the Audit

Data Analytics – Journal Entry Testing

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the Council's audit included testing journal entries, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis

We obtain downloads of all financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.

07 Focused on your future

Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: • How financial assets are classified and measured; • How the impairment of financial assets are calculated; and • The disclosure requirements for financial assets. There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.	Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to: • Reclassify existing financial instrument assets • Re-measure and recalculate potential impairments of those assets; and • Prepare additional disclosure notes for material items.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: • Leases; • Financial instruments; • Insurance contracts; and • For local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.	As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited. The standard is far more likely to impact on Local Authority Trading Companies who will have material revenue streams arising from contracts with customers. The impact on the Council, which does not have trading companies, is therefore unlikely to be significant.

Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.

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ED None

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