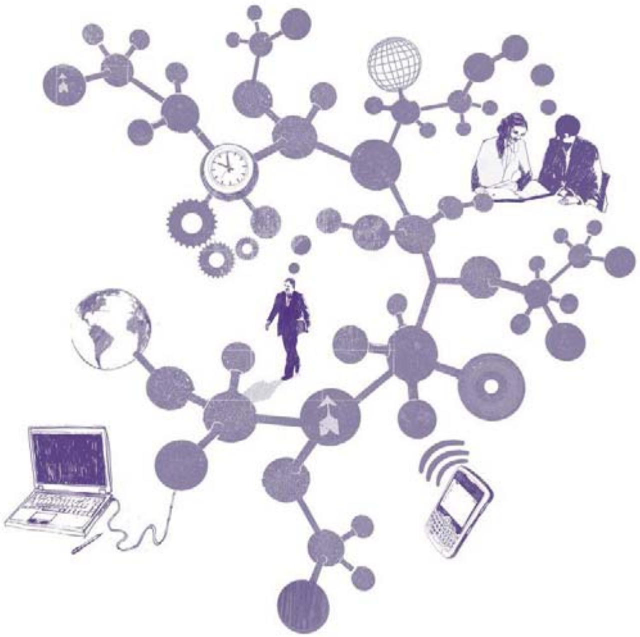
Appendix A

The Audit Findings for Herefordshire Council

Year ended 31 March 2014

September 2014



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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Contents

Section 1: Executive summary

Executive summary

Purpose of this report

This report highlights the key matters arising from our audit of Herefordshire Council's ('the Council') financial statements for the year ended 31 March 2014. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing 260 (ISA).

Under the Audit Commission's Code of Audit Practice we are required to report whether, in our opinion, the Council's financial statements present a true and fair view of the financial position, its expenditure and income for the year and whether they have been properly prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting. We are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources (the Value for Money conclusion).

Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, which we communicated to you in our Audit Plan in February 2014.

Our audit is substantially complete although we are finalising our work in the following areas:

- review of the final version of the financial statements
- obtaining and reviewing the final management letter of representation, and
- updating our post balance sheet events review, to the date of signing the opinion.

We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of matters brought to our attention by a local authority elector in relation to the Energy from Waste facility. We are satisfied that this work does not have a material effect on the financial statements or a significant impact on the value for money conclusion

We received draft financial statements and some accompanying working papers at the start of our audit.

Key issues arising from our audit

Financial statements opinion
We anticipate providing an unqualified opinion on the financial statements.

We asked management to make some adjustments to improve the presentation of the accounts which management agreed to do.

The key messages arising from our audit of the Council's financial statements are:
- The draft accounts presented for audit were of a good quality, a further improvement on previous years. We did not find any material errors in the statements.
- Many working papers were provided at the start of the audit and were fit for purpose. Most officers responded promptly to audit queries. Both of these areas were a significant improvement on previous years. There were still though some areas where it still took too long to obtain support for account balances. One particular improvement area for the future is the support to agree the statement of accounts to the ledger trial balance.
- We are pleased to see that the Council is very keen to continue this improvement and change processes to ensure an efficient closedown and audit next year and we are happy to help in this process. This will be important as the audit of accounts timetable moves forward in future years.

Further details are set out in section 2 of this report.

Value for Money conclusion
Based on the work completed to date to review the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources, we will be issuing an unmodified VfM conclusion. Despite an overspend in Adult Social Care of £3 million, the Council contained expenditure within the overall budget and at the same time increased reserves significantly. There is now greater assurance around the Medium Term Financial Plan and delivery of savings as the Council approaches the challenging years ahead.

The Council received an inadequate assessment from Ofsted in late 2012 in relation to its arrangements to safeguard children. It has subsequently worked hard through its Improvement Board to address the issues and in June this year Ofsted rated the Council as "in need of improvement".

The Council's waste solution was identified as a VfM risk as part of our audit planning and we have received a very high level of correspondence from the public raising specific concerns with us. In Section 3 we highlight a significant issue in relation to the documentation of reporting to members of officers views on the choice of technological solution in 2009.

Further detail of our work on Value for Money is set out in section 3 of this report.

Whole of Government Accounts (WGA)

We will shortly complete our work in respect of the Whole of Government Accounts.

Controls

The Council's management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we report these to the Council. There are no issues to report to you.
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The way forward

Matters arising from the financial statements audit and review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources have been discussed with the Chief Financial Officer and the finance team.

We have made some recommendations, which are set out in the action plan in Appendix A. Recommendations have been discussed and agreed with the Chief Financial Officer and the finance team.

Acknowledgment

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP
September 2014

Section 2: Audit findings

Audit findings

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and additional matters that arose during the course of our work. We set out on the following pages the work we have performed and findings arising from our work in respect of the audit risks we identified in our audit plan, presented to the Audit and Governance Committee in February 2014. We also set out the adjustments to the financial statements arising from our audit work and our findings in respect of internal controls.

Changes to Audit Plan

We have not made any changes to our Audit Plan as previously communicated to you on.

Audit opinion

We anticipate that we will provide the Council with an unmodified opinion.

Audit findings against significant risks

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty" (ISA 315).

In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards.

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
1.	**Improper revenue recognition** Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition	• review and testing of revenue recognition policies • testing of material revenue streams	Our audit work has not identified any issues in respect of revenue recognition.
2.	**Management override of controls** Under ISA 240 there is a presumed risk of management over-ride of controls	• review of accounting estimates, judgements and decisions made by management • testing of journal entries • review of unusual significant transactions	Our audit work has not identified any evidence of management override of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues. We set out later in this section of the report our work and findings on key accounting estimates and judgments.

Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan. Recommendations, together with management responses, are attached at Appendix A.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Operating expenses	Creditors understated or not recorded in the correct period. (Completeness)	We have undertaken the following work in relation to this risk: • Conducted a walkthrough of the key controls for this system, • Reviewed the monthly trend analysis of payments, • Performed cut off testing of purchase orders and goods received notes (both before and after year end), • Reviewed the completeness of the subsidiary system interfaces and control account reconciliations, and • Tested a sample of operating expenses and creditors.	Our audit work has not identified any significant issues in relation to the risk identified.
Employee remuneration	Employee remuneration accrual understated. (Completeness)	We have undertaken the following work in relation to this risk: • Conducted a walkthrough of the key controls for this system, • Reviewed the completeness of the reconciliations of information from the payroll system to the general ledger and financial statements, • Performed cut off testing of payments made in April and May to ensure payroll expenditure is recorded in the correct year, • Reviewed the monthly trend analysis of total payroll, and • Tested a sample of employee remuneration payments.	Our audit work has not identified any significant issues in relation to the risk identified. .

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property, plant & equipment	PPE activity not valid	We have undertaken the following work in relation to this risk: • Conducted a walkthrough of the key controls for this system, and • Tested a sample of PPE transactions covering the period 1/4/13 to 31/3/14	Our audit work has not identified any significant issues in relation to the risk identified.
Property, plant & equipment	Revaluation measurement not correct	We have undertaken the following work in relation to this risk: • Conducted a walkthrough of the key controls for this system, and • Reviewed the qualifications, terms of reference and the assumptions and methods used by the Valuer, in their work carried out as an expert for the Council, and • We have reviewed the valuation reports produced to support the accounting entries.	Our audit work has not identified any significant issues in relation to the risk identified. Officers need to consider their current valuation programme to ensure that the requirements of the code (now clarified in relation to classes of asset) are met.
Welfare Expenditure	Welfare benefit expenditure improperly computed	We have undertaken the following work in relation to this risk: • Conducted a walkthrough of the key controls for this system, and • Tested a sample of welfare benefit transactions covering the period 1/4/13 to 31/3/14	Our audit work has not identified any significant issues in relation to the risk identified.

Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	The Council's policy on revenue recognition is included in note 41 of the Statement of Accounts.	• The Council's policy is appropriate and consistent with the relevant accounting framework – the Local Government Code of Accounting Practice • Minimal judgement is involved • The accounting policy is properly disclosed	●
Judgements and estimates	Key estimates and judgements include: • Useful life of capital equipment , • Pension fund valuations and settlements, • PFI • Revaluations, • Impairments, and • Provisions.	• The Council's policy is appropriate and consistent with the Local Government Code of Accounting Practice • Reliance on experts is taken where appropriate • Accounting Policies are properly disclosed • We have reviewed the accounting models the Council have used to calculate the entries required in the accounts for the three current PFI schemes in operation. We have compared these to our standard accounting model to provide some independent evidence over the accuracy of the estimate used. We are satisfied that these estimates are materially accurate.	●

Accounting area	Summary of policy	Comments	Assessment
Other accounting policies	• We have reviewed the Council's policies against the requirements of the CIPFA Code and accounting standards.	• Our review of the revised accounting policies has not highlighted any issues which we wish to bring to your attention.	●

Assessment

- ● Marginal accounting policy which could potentially attract attention from regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

Adjusted misstatements

A number of adjustments to the draft financial statements have been identified during the audit process. We are required to report all misstatements to those charged with governance, whether or not the financial statements have been adjusted by management. The table below summarises the adjustments arising from the audit which have been processed by management.

Impact of adjusted misstatements

All adjusted misstatements are set out below along with the impact on the primary statements and the reported financial position.

	Detail	Statement/Notes effected
1	none	

Misclassifications & disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

	Adjustment type	Account balance	Impact on the financial statements
1	Disclosure	PBSE	An additional statement to note the contract variations signed in May 2014 in relation to the Waste PFI was made to the draft accounts presented for audit. This was necessary given the timeline for the production of the accounts and the financial close on the contract variation.
2.	Disclosure	Explanatory Foreword	Figures were amended in the Explanatory Foreword to ensure consistency with the notes in the Statement of Accounts
3	Disclosure	Note 8.92.2	Prior year figures in note 8.92.2 for integrated community equipment were amended.
4.	Disclosure	Note 8.12.6	A note was added to inform the reader of the significant change in accounting policies in relation to schools in 2014/15.
5.	Disclosure	Note 8.42	Further disclosures were added to note 8.42- financial instruments in relation to defined benefit pensions.
6.	Disclosure	Note 33	Note 33 on Direct Schools Grant was amended to take account of three schools which had moved to academy status. The figure in the Comprehensive Income and Expenditure Account was correct.
7	Disclosure	Note 8.1.99	Disclosure was added regarding the transfer of public health functions and the effect on financial statements.
8	Disclosure	Accounting policies	Accounting policies were added in relation to the timing of de-recognition of schools transferring to academy status, revenue recognition of council tax and business rates, the approach to depreciating Property Plant and Equipment components, the accounting for maintained school's income, expenditure. liabilities and reserves and the impact on changes in business rates.

Unadjusted misstatements

The table below provides details of adjustments identified which we request be processed but which have not been made within the final set of financial statements. The Audit and Governance Committee is required to approve management's proposed treatment of all items recorded within the table below:

Detail	Reason for not adjusting
None	

Other communication requirements

We set out below details of other matters which we are required by auditing standards to communicate to those charged with governance.

	Issue	Commentary
1.	**Matters in relation to fraud**	• We have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit.
2.	**Matters in relation to laws and regulations**	• We are not aware of any significant incidences of non-compliance with relevant laws and regulations.
3.	**Written representations**	• A letter of representation has been requested from the Council.
4.	**Disclosures**	• Our review found no material omissions in the financial statements
5.	**Matters in relation to related parties**	• We are not aware of any related party transactions which have not been disclosed
6.	**Going concern**	• Our work has not identified any reason to challenge the Council's decision to prepare the financial statements on a going concern basis.

Section 3: Value for Money

Value for Money

Value for Money conclusion

The Code of Audit Practice 2010 (the Code) describes the Council's responsibilities to put in place proper arrangements to:

- secure economy, efficiency and effectiveness in its use of resources
- ensure proper stewardship and governance
- review regularly the adequacy and effectiveness of these arrangements.

We are required to give our VfM conclusion based on the following two criteria specified by the Audit Commission which support our reporting responsibilities under the Code:

- **The Council has proper arrangements in place for securing financial resilience.** The Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
- **The Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness** The Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Key findings

Securing financial resilience

We have undertaken a review which considered the Council's arrangements against the following three expected characteristics of proper arrangements as defined by the Audit Commission:

- Financial governance;
- Financial planning; and
- Financial control

The Council, like most others nationally, continues to face challenges in how to balance its budget. The outturn position for 2013/14 shows that the budget has been achieved. This was a positive achievement considering the forecast in October 2013 of a £2m deficit. In reaching this position, significant savings have been made, however, some were achieved through one-off measures rather than the planned recurrent savings. The Council obtained a direction approval from CLG to allow it to charge £1.6m of transformation revenue costs to capital. Plans are in place to convert this to recurrent savings in 2014/15. While similar pressure points to previous years remain, for example Adult Social Care, arrangements to monitor and manage these financial challenges have improved and appear robust. Overall, we consider the Council's medium term financial plan (MTFP) to have been strengthened in the year and that it has appropriate budget setting and monitoring arrangements in place. In Appendix D we include our ratings of four key areas in our financial resilience work.

Challenging economy, efficiency and effectiveness

We have reviewed whether the Council has prioritised its resources to take account of the tighter constraints it is required to operate within. Our work has focused on how the Council has delivered its savings programme in 2013/14 and its plans for delivering savings in future years. Our overall conclusion was that, although there was significant non delivery of savings in 2013/14, in the main, this was the result of over-optimism in the timing of delivery. The delivery of savings was more effective in 2013/14 than in previous years and there is now greater assurance on savings delivery in 2014-15. There is scope to improve the way that savings schemes are project managed and monitored and also the quality of information provided to Members on the progress of schemes. In addition the Council received an inadequate assessment from Ofsted in late 2012 in relation to its arrangements to safeguard children. It has subsequently worked hard through its Improvement Board to address the issues and in June this year Ofsted rated the Council as "in need of improvement".

As part of the audit plan, we highlighted specific risks in relation to the VFM conclusion. These were;

- The introduction of the Better Care Fund,
- Plans for the new energy to waste plant at Hartlebury.
- Arrangements to safeguard children, and
- Financial resilience as reflected by MTFS and in particular the impact of continued overspending in Adult Social Care.

In addition we received a Public Interest Disclosure Act (PIDA) from a member of staff in relation to the procurement and implementation of a customer interface IT system, CRM, and carried out further work to look at the concerns raised.

Public Interest Disclosure Act

Our investigation in response to the PIDA referral suggested that the Business Case for the project was very ambitious and not fully owned by all parts of the Council. The estimated cashable savings of £1.6m identified in the Business Case were not supported by robust analysis and were premised on centralising services and therefore reducing back-office costs in departments. In reality the project did not subsequently extend to all of the services envisaged within the Business Case, so it is unlikely that key elements of the cashable savings were realised.
Our review of the procurement of CRM suggests that the Council appears to have carried out an appropriate tendering process with sufficient safeguards built in to ensure fairness and transparency. Following this, the Council implemented a shared front office and this is still in operation and working reasonably effectively, but the project did not, as envisaged by the Business Case: extend to all council services and partners; provide complete visibility of all customer information or allow proactive or 'intelligent' action in response to customer data which were all key planks of the original plan
:

The project has delivered benefits but the Council's own post-implementation review concluded that it has only been partially successful and that momentum has stalled for a number of reasons

- the world changed: the Primary Care Trust was abolished and other services were divested and key providers no longer contract with the Council
- the impact of Austerity meant that the Council could no longer fund the full implementation of the project and the back-office savings which were supposed to be delivered by CRM were probably delivered by other means
- the Council's model of seeking to provide services to meet all customer demand has changed to one of seeking to constrain demand and enable self-service where practicable
- there was insufficient corporate and departmental support to extending the project further

It is difficult to gauge whether the £1m spent on the project provided value for money. It is unlikely that CRM delivered all of the costs savings on which the Business Case was premised and the system is possibly over-engineered for its current use. Going forward the Council needs to be clearer about the scope and ambition of its customer vision and what this means for the way it engages with all customers in future and the digital and other channels it needs to deploy to support that vision. It is important that the Council learns lessons from this project. Our detailed report includes recommendations. The Audit and Governance Committee has asked for a detailed action plan to address these and also pick up any wider lessons.

Better Care Fund

We have also considered the work undertaken by partners across Herefordshire to agree and develop the Better Care Fund Plan. We are able to conclude that the partnership to date has achieved the timescale and assurance requirements set by NHS England.

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Herefordshire submitted its Better Care Fund plans in line with the national timetable. Whilst resources committed in 2014/15 are limited, sums to be pooled are likely to increase considerably beyond then. It will be critical that the Better Care Fund Plans will achieve integrated services and reductions in emergency admissions for the future financial stability of health and social care services in Herefordshire

The plans are still in the early stages of development for the period beyond 2014/15 and there are some considerable financial challenges within the local government and health economy.

Energy to Waste project

Given the large volume of correspondence from members of the public and the unique nature of the arrangement, we have undertaken a detailed review of the arrangements in relation to the energy to waste plant.

Residual Risk identified

The Worcestershire and Herefordshire Waste Private Finance Initiative (PFI) contract with Mercia Waste Management Ltd was set up in December 1998 with the intention of developing a waste disposal facility that would come on stream early in the contract. It was predominantly based around what was then described as a waste to energy facility for which planning permission was subsequently not obtained. Since planning permission was refused in April 2001, alternative technologies and ways forward have been explored to help allow both parties to meet national targets for recycling and reduce the amount of waste which ends up in landfill sites. In December 2013 the Council's Cabinet agreed to enter a variation to the existing waste contract to provide and Energy from Waste (EfW) in Hartlebury (North Worcestershire). The residual risk identified was that arrangements are not in place to ensure that this variation to the existing waste contract provides value for money.

Overview of work undertaken

We have reviewed the arrangements that the Council has put in place to ensure that a variation to the existing waste disposal contract to provide for an Energy from Waste plant in Hartlebury provides value for money. This included a review of the assessment carried out by the Council in December 2013 and also the earlier assessment of the choice of technology in 2009. As part of this work, we assessed whether the Council has taken appropriate and timely expert advice.

Summary of findings

In December 2013 the Council's Cabinet agreed to enter a variation to the existing waste contract to provide an (EfW) plant in Hartlebury and the contract variation was subsequently completed in May 2014. The December Cabinet meeting considered the option of constructing an EfW plant against other options such as "do nothing" and termination of the existing contract. It also considered alternative methods of financing the EfW plant such as private finance, mixed private finance and prudential borrowing and prudential borrowing. The assessment included both a quantitative appraisal which had been supported by the Council's financial advisers, Deloitte, and also qualitative factors.

The financial appraisal also quantified risks identified in meetings of council officers and their advisers. The assessment concluded that procuring an EfW plant through prudential finance as a variation to the existing contract was the best of the options over the whole life of the plant. The Council assessed the impact of changes to some of the key assumptions used to model the cost of the options such as changes in waste volumes and increases to landfill tax. The Council has taken appropriate expert advice to inform its decisions. This has included financial, legal and technical advice

It is clearly vital in a project of this size which has a long term impact that members are provided with all relevant information to allow them to make a considered decision. We reviewed the key decisions in this project and one of these was the choice of technology to deal with residual waste which was effectively made in 2009.

We have identified a significant issue in relation to the documentation supporting the reporting to members of officers' views of the preferred technological solution and the reasons for this to help make an informed decision. There was no detailed accompanying report to Cabinet setting out why officers (rather than consultants) considered that this choice of technology provided better value for money over other options available, taking account of cost and other key factors. Instead the accompanying officer report to the December 2009 Cabinet made reference to the fact that the technology proposed by Mercia had been ranked highly in the consultants ERM options appraisal (which had been commissioned to support the Joint Municipal Waste Management Strategy).

Appendix B contains more detail on our work.

Adult Social Care

For several years the Adult Social Care budget in Herefordshire has overspent and in 2012/13 the budget was overspent by £5.9m due mainly to the failure to deliver very ambitious and unrealistic savings targets.

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Very early in 2013/14, the Council discovered that it had counted grant income of £3.8m twice in its budget. A Special Council Meeting was called to start to address the issue

Following previous external audit criticisms, the Council has strengthened its budget setting processes for 2014/15 including the use of zero-based budgeting and greater challenge from Finance. In 2013/14 Adult Social Care overspent by £3m, which was not only a smaller deficit than previous years, but also an improvement from the October forecast of £4m. There was slippage in the delivery of savings for several reasons and in particular the lack of challenge over over-optimistic assumptions on the rate of delivery. There was no contingency to deal with this in 2013/14.

In 2014/15 the Adults and Wellbeing directorate is broadly forecasting a break-even position and there is now greater assurance over the delivery of savings. This is due to the fact the Council has given greater priority to carrying out the reforms to Adult Social Care delivery needed. The Adult Social Care budget will continue to carry significant risk, both in the short and medium term. In particular, the Council, like others, still carries uncertainty over the full financial impact of the Care Bill.

The Council recognises it still needs to establish a working commitment accounting system in Adult Social Care so that managers have a better understanding of the financial consequence of decisions made; a point first made by external auditors five years ago. Work continues on this development.

Safeguarding children

An announced inspection by Ofsted of the Council's arrangements to safeguard children was carried out in September 2012 and these arrangements were assessed overall as "inadequate" across all three Ofsted review categories. An improvement notice was issued in February 2013. The Council drew up an improvement plan in October 2012 and set up a multi agency Improvement Board with an independent Chairman. The Council has made several significant changes to address the issues set out in the Ofsted report and there has been regular reporting on progress against the Improvement Plan, including reports to Cabinet. The Council also invited in a LGA peer review team. Ofsted issued a report in 30 June 2014. This removed the "inadequate" rating. Overall the Council was assessed as "in need of improvement" and in each of the three sub-categories The Council recognises that there is still more to do, not least in addressing the large number of temporary staff employed in key posts. There are also issues around the accuracy and accessibility of electronic systems to record details about children and families to allow managers to understand what services are needed and how well they work. A detailed action plan has been drawn up to address the outstanding issues.

Overall VFM conclusion

We are issuing an unqualified VfM conclusion based on the issues examined. In particular our consideration takes into account the size of annual waste expenditure involved in relation to the Council's total gross budget and also that the shortcomings we found in the reporting of the preferred waste technological solution in 2009 were not in our view typical of the decision making we normally see at the Council.

As such, on the basis of our work, and having regard to the guidance on the specified criteria published by the Audit Commission, we are currently 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 2014.

Section 4: Fees, non audit services and independence

Fees, non audit services and independence

We confirm below our fees charged for the audit.

Fees

	Per Audit plan £	Actual fees £
Council audit*	164,803	TBC
Grants	8,400	5,795
PIDA (proposed)		11,140
Total fees	**173,203**	**TBC**

*Both the significant level of correspondence from the public and the unique nature of the arrangements surrounding the waste contract means that the level of risk attached to the audit is significantly higher than envisaged by the Audit Commission when setting the scale fee which is quoted above. Work is on-going to determine the level of fee variation required for this work, particularly as we continue to receive correspondence in this area which we have a statutory duty to consider. We will discuss the level of additional fee required with officers and then submit this for approval to the Audit Commission. There is an additional fee of £1,050 in respect of work on material business rates balances. This additional work was necessary as auditors are no longer required to carry out work to certify NDR3 claims. The additional fee is 50% of the average fee previously charged for NDR3 certifications for unitary councils and is subject to agreement by the Audit Commission.

Fees for other services

Service	Fees £
None	Nil

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

Section 5: Communication of audit matters

Communication of audit matters to those charged with governance

International Standard on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks when reaching our conclusions under the Code.

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Compliance with laws and regulations		✓
Expected auditor's report		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

Appendices

Appendix A: Action plan

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
1	The Council should continue to redesign the process for closedown and audit of the accounts to ensure a more efficient process.	High	The aim is to closedown the accounts and audit one month earlier for the 2014/15 year end	August 2015 Head of Technical Finance
2	Officers need to consider their current valuation programme to ensure that the requirements of the code (now clarified in relation to classes of asset) are met.	Medium	Draft policy is in circulation and valuation work has commenced	Policy to be agreed by 1st November 2014 Head of Technical Finance
3	The Council needs to improve the project management and monitoring of savings schemes, including the information provided to Members on progress.	High	Continuous Improvement Programme work is including monitoring savings which will include the reporting to members. Cabinet reporting to be reviewed for further improvements going forward	On-going process Chief Finance Officer
4	The Council should ensure that it has a working commitment accounting system in Adult Social Care.	High	Transformational work is underway with delivery of outcomes expected in early 2015	February 2015 Chief Finance Officer

Appendix B: Detailed reporting on Energy from Waste Plant

The Worcestershire and Herefordshire Waste Private Finance Initiative (PFI) contract with Mercia Waste Management Ltd was set up in December 1998 with the intention of developing a waste disposal facility that would come on stream early in the contract. It was predominantly based around what was then described as a waste to energy facility for which planning permission was subsequently not obtained. Since planning permission was refused in April 2001, alternative technologies and ways forward have been explored.

There is a high level of public interest in future waste disposal arrangements and we have received an exceptionally high number of enquiries from members of the public. As a result of the level of public interest and in response to the level of risk involved, we have reviewed the current situation as part of our audit. In particular , we have focussed on the arrangements the Council has in place to ensure that value for money was obtained from any variation to the contract. We provide below a summary of our conclusions to date from the work.

For many years the Council has been seeking, with its partner Worcestershire Council, to vary its privately funded contract for waste management which will allow both parties to meet national targets for recycling and reduce the amount of waste which ends up in landfill site. In December 2013 the Council's Cabinet agreed to enter a variation to the existing waste contract to provide an Energy from Waste (EfW) plant in Hartlebury in North Worcestershire and the contract variation was subsequently completed in May 2014.

The December 2013 Cabinet meeting considered the option of constructing an EfW plant against other options such as "do nothing" and termination. It also considered alternative methods of financing the EfW plant such as private finance, mixed private finance and prudential borrowing and prudential borrowing. The assessment included both a quantitative appraisal which had been supported by the Council's financial advisers, Deloitte, and also qualitative factors. The financial appraisal included a quantification of risks identified in meetings of Council officers and their advisers. The quantitative appraisal used discounting techniques to take account of the profiles of expenditure for each of the options as would be expected in any large capital project decision.

The Council also assessed the impact of changes to some of the key assumptions used to model the cost of the options such as changes in waste volumes and increases to landfill tax. The preferred option from a value for money perspective remained unchanged even where more pessimistic assumptions were employed by the Council's advisers. The assessment concluded that procuring an EfW plant fully financed through prudential borrowing as a variation to the existing contract was the best of the options over the whole life of the plant.

The December Cabinet report concluded that, in net present cost terms, the chosen option would be £128 million cheaper than the "continue as is" option. over the 25 year period post construction. The report stated that it would add around £6.6 million to the annual unitary charge to be paid to the contractor.
The choice of technology has been the subject of public debate. In 2009 there was an evaluation of options as part of the review of the Joint Municipal Waste Management Strategy (JMWMS). Members were consulted with, focus groups were held and there was engagement with businesses. A large postal survey was undertaken from which there was a reasonable response rate. The consultation was made available on-line. The consultation identified that a key focus for the public

was climate change and that informed the strategy and final decisions. Value for money and waste prevention were also issues raised through the public consultation. The options appraisal was undertaken by consultants ERM, experts in this type of work, using a recognised and supported analysis model. A wide range of options were initially identified and a set of criteria used to identify the preferred option.

The option chosen was not necessarily the cheapest but the option identified as scoring most highly had benefits which others did not, including that it was tried and tested technology, which had been identified by the Councils as being a critical factor. The options appraisal was not weighted, in line with DEFRA advice at the time, but drew attention to the three key criteria which the Council considered most important. These criteria were developed in a workshop attended by officers and members. It took no account of transportation costs and income from heat energy and other recyclables on the advice of consultants who also stated that this would not have changed the outcome of the process. This option appraisal was refreshed by the same consultants in 2012 and the consultants concluded that the initial appraisal was still valid.

Whilst the options appraisal supporting the JMWMS carried out by ERM appeared thorough, the report to Cabinet recommending support for the choice of technology lacked detail and clarity. The September 2009 Cabinet had approved a JMWMS which was now neutral on the technology to deal with residual waste as opposed to the previous strategy which had favoured autoclave technology. However as previously mentioned, the JMWMS was supported by an options appraisal produced by ERM which ranked energy from waste highly and this was included as an appendix to the September Cabinet report. The September Cabinet report stated that this options appraisal would inform the choice of future treatment of residual waste and that Mercia would be asked to come forward with a proposal. The Cabinet minutes of December 2009 resolved to support, in principal, the concept contained within the Energy from Waste (EfW) proposal subsequently put forward by Mercia.

Whilst this was the point that the choice of technology was effectively made, there was no detailed accompanying report to Cabinet setting out why officers (rather than consultants) considered that this choice of technology provided better value for money over other options available, taking account of cost and other key factors. Instead the accompanying officer report made a short reference to the fact that this technology proposed by Mercia had been ranked highly in the ERM report. We would have expected a detailed officer report considering the scale of the decision which referred to and built on the ERM report. The solution proposed in December 2009 was an EfW plant with combined heat and power. Subsequently, due to the choice of site, a decision was made to provide an EfW plant which was "CHP-enabled". Whilst we can understand this decision, we cannot see where this change was reported to Cabinet until December 2013.

Project management arrangements have been in place for several years and a detailed project plan was developed. The Council understood and managed the risks associated with the project which including land use, planning, procurement, and contractual risk. Extensive external advice has been sought to understand and mitigate risks. This has included financial, legal and technical advice. In addition to the advisers already referred to, the Council employed consultants to ensure that the costs of running the EfW plant compared well with other recently procured plants and that the planned maintenance schedule, if followed, would ensure the plant is maintained to a standard which means that at contract termination the plant is in a condition which would be expected of its age. We are also aware that the Council sought advice in determining future waste volumes and recycling rates to help determine the appropriate size of plant.

Clearly a complex project of this size will continue to present significant risks and amongst these is the risk of future legislative change which may increase costs of the EfW plant. In this respect the Council obtained advice from its technical adviser, AMEC, that it was considered unrealistic to require the potential costs of these foreseeable but unquantifiable legislative changes to be included within the costed proposals except where firm proposals were available, for example legislation requiring Royal Assent. The advisers report that the contract does include a mechanism to deal effectively with such eventualities should they transpire.

Members will be aware that on 17 June 2014, the National Audit Office (NAO) issued a report on the oversight of three PFI waste projects, including that of the Herefordshire and Worcestershire. Their review focussed on how the Department for Environment, Food and Rural Affairs (DEFRA) oversees the three PFI waste projects. We met with the NAO recently to discuss their findings. The NAO highlighted two issues which the Treasury and DEFRA believed were not yet satisfactorily resolved. These were:

- whether the Councils needed to act as the sole finance provider for the project, rather than just one lender alongside a banking group; and
- the valuation of the EfW facility when the contract ends, given that the contractor will operate the facility for a much shorter period than originally envisaged.

Appendix C: Audit Opinion

We anticipate we will provide the Council with an unmodified audit report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEREFORDSHIRE COUNCIL

Opinion on the Authority financial statements

We have audited the financial statements of Herefordshire Council for the year ended 31 March 2014 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Collection Fund and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

This report is made solely to the members of Herefordshire Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's Members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Chief Financial Officer and auditor

As explained more fully in the Statement of the Chief Financial Officers' Responsibilities, the Chief Financial Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Financial Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited financial statements and to identify any information which is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of Herefordshire Council as at 31 March 2014 and of its expenditure and income for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and applicable law.

Opinion on other matters

In our opinion, the information given in the explanatory foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
- we issue a report in the public interest under section 8 of the Audit Commission Act 1998;
- we designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
- we exercise any other special powers of the auditor under the Audit Commission Act 1998.

We have nothing to report in these respects.

Conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources

Respective responsibilities of the Authority and the auditor

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

We are required under Section 5 of the Audit Commission Act 1998 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2013, as to whether the Authority has proper arrangements for:

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

The Audit Commission has determined these two criteria as those necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2013, we are satisfied that, in all significant respects, Herefordshire Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of matters brought to our attention by a local authority elector in relation to the Energy from Waste scheme. We are satisfied that these matters do not have a material effect on the financial statements or a significant impact on our value for money conclusion.

Appendix D-financial resilience ratings

We use a red/amber/green (RAG) rating with the following definitions.

Green	Adequate arrangements appear to be in place
Amber	Adequate arrangements, with areas for development
Red	Inadequate arrangements

Risk area	Summary observations	High level risk assessment
Key Indicators of Financial Performance	We assessed a number of your 2013/14 key financial indicators and there was a mixed position. Sickness absence and schools balances were rated green. Sickness absence in 2013/14 averaged 4.15 days per staff member and was much lower than the public sector average and an improvement from last year. Schools balances are higher than average based on 2012/13 figures but there are some high schools balances which would warrant further investigation by the Council. We assessed long term borrowing as green. Long- term borrowing in 31/3/2013, when compared to both revenue and long term assets, was close to the average of other similar councils. These comparisons do not take account of the relatively high short term borrowing and PFI. We assessed reserves as green (as opposed to red last year). Even though the latest 2012/13 comparative figures show Herefordshire as having the lowest useable reserves of similar councils in relation to annual expenditure, the 2013/14 position in Herefordshire has considerably strengthened (although comparative figures for other similar councils are not yet available). The liquidity ratio (current assets over current liabilities) was assessed as amber. The Council has the second lowest ratio using 2012/13 comparative figures. The Council attribute this to accounting technicalities which require the £12m of LOBO loans to be treated as current liabilities, although it is considered highly unlikely that these will be called in in the short-term. It is also the current treasury management policy to borrow in the short term to take advantage of low interest rates. If borrowing is excluded the position exceeds 100%.	Green
Strategic Financial Planning	The Council agreed a budget for 2013/14 in February 2013. Due to an error identified in the initial budget by finance staff (a £3.8m Department of Health grant was double-counted) a revised budget was taken to Council in May which increased the savings required to be made in 2013/14. The Council has since tightened the controls over budget setting to prevent a re-occurrence. In developing its 2014/15 budget plans the Council considered and employed a range of initiatives, including service redesign and alternative methods of provision. There is as a result greater assurance over the 2014-15 position. The 2014/15 budget papers available to members have been updated and improved, showing a clear link with council key priorities. The Chief Financial Officer held a cross party budget consultation event in December 2013 which was the culmination of an engagement process undertaken with members through the autumn. The budget proposals were considered by General Overview and Scrutiny Committee. The Council consulted with the public on the proposed budget for 2014/15 and the financial plan 2014/15 to 2016/17.	Green

Area of focus	Summary observations	RAG-Rating
Financial governance	The Council has improved the governance arrangements in place in response to the difficult financial environment. There is now the discipline of regular financial reporting and challenge meetings chaired by the Section 151 Officer with subsequent reporting to Cabinet. As a result the Council's financial environment and financial performance is better understood at all levels of the organisation. There is scope to improve the project management and monitoring of savings and reporting of delivery of savings to members.	Green
Financial control	The overspend in 2012/13 in Adult Social care was £5.9 million and this caused the Council to overspend overall by £1.4 million. Fundamentally this was caused by an unrealistic budget being set for this service and in particular unrealistic assumptions on the impact of savings schemes. In 2013/14 the overspend in this area was reduced to £3 million and the Council overall contained expenditure within budget. The Council obtained a direction approval from CLG to allow it to charge £1.6m of transformation revenue costs to capital. This was still a real achievement given the reported deficit position in October 2013. The Council has taken action to make the budget more realistic. There is now greater assurance on the 2014-15 position and savings. The Council has adequate financial controls overall. The Council needs to continue to improve the quality of financial forecasting in Adult Social Care and also establish a working commitment accounting system in this area. Finance staff both in the Council and in the Council's jointly owned shared services company, Hoople are experienced and appropriately qualified. There has been a restructure of the Finance team, bringing Hoople and Council finance staff together. The Council has replaced its internal audit service to obtain better value for money .	Green

Grant Thornton