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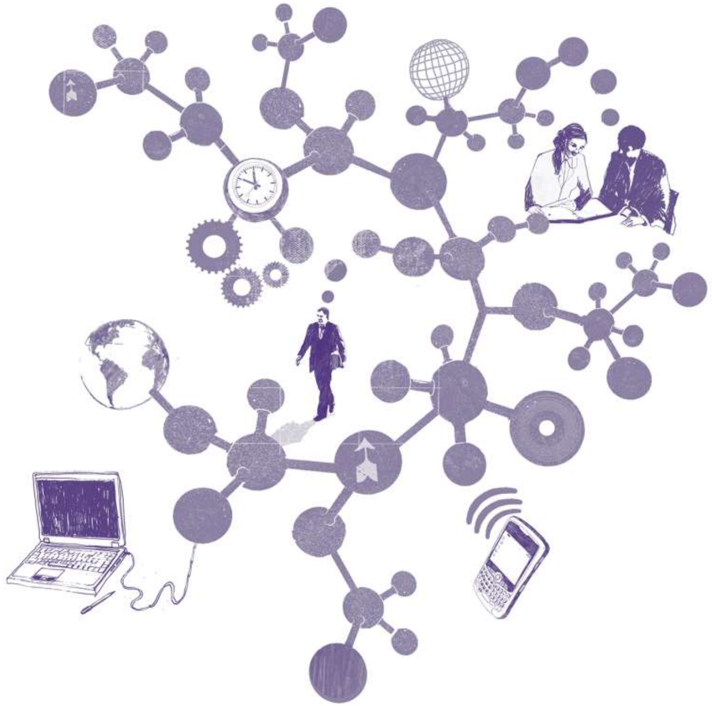
This version of the report is a draft. Its contents and subject matter remain under review and its contents may change and be expanded as part of the finalisation of the report.

The Audit Findings for Herefordshire Council

Year ended 31 March 2017

September 2017



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20 September 2017

Dear Members of the Audit and Governance Committee

Audit Findings for Herefordshire Council for the year ending 31 March 2017

This Audit Findings report highlights the key findings arising from the audit that are significant to the responsibility of those charged with governance (in the case of Herefordshire Council, the Audit and Governance Committee), to oversee the financial reporting process, as required by International Standard on Auditing (UK & Ireland) 260, the Local Audit and Accountability Act 2014 and the National Audit Office Code of Audit Practice. Its contents have been discussed with officers.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland) ('ISA (UK&I)'), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

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 and giving a value for money conclusion. 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.

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

Yours faithfully

Phil Jones

Engagement lead

Contents

Section 1: Executive summary

Purpose of this report

This report highlights the key issues affecting the results of Herefordshire Council ('the Council') and the preparation of the Council's financial statements for the year ended 31 March 2017. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of ISA (UK&I) 260, and the Local Audit and Accountability Act 2014 ('the Act').

Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion, the Council's financial statements give a true and fair view of the financial position of the Council and its income and expenditure 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 consider other information published together with the audited financial statements (including the Annual Governance Statement (AGS) and Narrative Report, whether it is consistent with the financial statements, apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Council acquired in the course of performing our audit; or otherwise misleading.

We are required to carry out sufficient work to satisfy ourselves on whether the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion'). Auditor Guidance Note 7 (AGN07) clarifies our reporting requirements in the Code and the Act. We are required to provide a conclusion whether in all significant respects, the Council has put in place proper arrangements to secure value for money through economic, efficient and effective use of its resources for the year.

The Act also details the following additional powers and duties for local government auditors, which we are required to report to you if applied:

- a public interest report if we identify any matter that comes to our attention in the course of the audit that in our opinion should be considered by the Council or brought to the public's attention (section 24 of the Act);
- written recommendations which should be considered by the Council and responded to publicly (section 24 of the Act);
- application to the court for a declaration that an item of account is contrary to law (section 28 of the Act);
- issue of an advisory notice (section 29 of the Act); and
- application for judicial review (section 31 of the Act).

We are also required to give electors the opportunity to raise questions about the accounts and consider and decide upon objections received in relation to the accounts under sections 26 and 27 of the Act.

Introduction: Accounts Audit

In carrying out the audit we have not had to alter or change our overall audit approach, which we communicated to you in our Audit Plan dated March 2017. As at 31 August 2017 there are three material uncertainties in the accounts which remain unresolved, relating to matters which were first raised up to six months ago. This is disappointing. There are also adjustments to be made to the accounts which we will need to review. We have discussed with officers how they plan to provide us with sufficient information to enable these matters to be resolved to our satisfaction. If these matters are not resolved by the 30 September deadline this will result in either a delayed opinion or a modification to the opinion. In summary the matters are:

- **Hoople Local Government Pension Liabilities (LGPS):-**The accounts have now been adjusted to exclude post 2011 Hoople pension liabilities, which were incorrectly included for the first time this year. The revised accounts continue to reflect Hoople pension liabilities accrued up to the point of transfer. The Council has supplied a guarantee to Hoople in respect of the LGPS liabilities, so the Council has a financial obligation that it must account for, reflecting local circumstances. This obligation is not reflected in the revised accounts and we currently have no information to assess how material this matter is.

- **Energy from waste PFI:** the accounts include £33.4m of additions to Property Plant and Equipment (PPE) related to this project. The Council has not demonstrated that the asset has been valued in accordance with the CIPFA Code. Worcestershire County Council has now commissioned a valuation of the PFI asset. We currently do not have a timescale for return of that information or the likely financial impact on the accounts.

- **Valuation of Property Plant & Equipment (PPE):** the Council provided information that indicated that PPE was materially misstated. This is because insufficient valuations had been undertaken to ensure the asset base reflects current market conditions, in accordance with the Code. We agreed with officers an approach to resolve this matter and that additional work has recently been completed, in consultation with the professional valuer. We have yet to complete our review of the working papers to support this assessment.

Further details on these and a number of other accounting issues arising are referred to later in the report. The audit has proved challenging this year as it has taken a considerable amount of time to resolve, to our satisfaction, a range of material accounting issues, as well as a number of more routine matters. We are finalising our audit procedures in the following additional areas:

- Obtaining and reviewing the final draft version of the accounts, ensuring that they reflect the various agreed changes made to the accounts
- Finalising the work on welfare benefits
- Completing our testing on investment properties
- Completion of our work on the IAS19 disclosures
- Obtaining and reviewing the management letter of representation
- Review of revised versions of the Annual Governance Statement
- Updating our post balance sheet events review, to the date of signing the opinion
- Whole of Government Accounts

We received draft financial statements and accompanying working papers at the commencement of our audit in June. The accounts were not of a good quality and contained a larger number of material errors than we would have normally anticipated. They did not properly reflect the revised requirements of the CIPFA code in some key areas. The notes to the accounts were also inadequate in a number of instances. The number of changes to figures in the accounts and disclosures set out in this report is accordingly considerably larger than in prior years. In part this can be attributed to a significant number of changes within the Finance department in the last year, and in particular, the absence of the Council's experienced Deputy S151 Officer. Better progress has been made in resolving issues since her return.

To progress the audit and resolve issues, regular progress meetings have been held with officers, followed up by emails summarising discussions, outstanding matters and agreed actions. The errors in the compilation of the accounts would, in our view, have been reduced had a stronger quality review process been in place, to ensure that the draft accounts submitted to audit complied with all Code requirements and adequately explained items of key financial significance.

The conduct of the audit was impacted by other factors. For instance, the absence of the Acting Corporate Finance Manager (ACFM) for the first two weeks of the audit visit, due to annual leave, delayed progress as it was difficult to obtain responses to audit questions during the period. Key sample data that we required was also often incomplete and difficult to follow. The ACFM attributed this to a lack of capacity to quality-review information prior to it being submitted to auditors.

Commitment to providing an adequate response to audit questions was also mixed. Auditors are required to challenge and seek additional evidence, where necessary, to gain sufficient audit assurance. Officers, in our view, did not always provide adequate evidence to support balances or key judgements made, which built delays into the conduct of the audit. In some instances, for instance the sale of the agricultural assets, it took several months for officers to agree to make changes to the accounts, which were required to improve transparency and aid readers' understanding of the accounts. We also, for instance, questioned why the draft accounts showed a transfer of £14.3m of investment properties to infrastructure assets. Months later it transpired that this was an accounting error, and the £14.3m transfer was in fact the result of an impairment of the asset resulting in a corresponding adjustment to the accounts required. Two of the three material matters still outstanding were also initially raised with officers at the interim stage of the audit, some 6-7 months ago.

The delays we experienced in progressing the audit, often involved an unnecessary escalation of issues in order to secure an adequate response to reasonable requests for information and evidence. These processes worked better in prior years in our view.

With the return of the Deputy S151 Officer, we would hope that there would be an improvement in these processes. However, the deadline for completion of the audit of the 2017/2018 accounts by 31 July 2018 will not be achieved unless quality processes over accounts production are strengthened and better working papers are produced to evidence key figures in the accounts, accounting treatments and decisions made.

Key audit and financial reporting issues

Financial statements opinion

The draft accounts presented for audit were not compliant with the requirements of the CIPFA Code of Practice in some key areas. We expect our concerns to be addressed in the revised draft of the accounts. Further details are contained in section 2 of the report

In order to improve arrangements for 2017/18 the Council needs to:

- Quality review the draft accounts including proper consideration by senior officers of compliance with the disclosure requirements of the Code
- More effectively demonstrate compliance with the accounting requirements of the Code, particularly around the classification and valuation of property plant and equipment.
- Challenge and quality review the information provided by third parties, in particular property values, before including it in the accounts.
- Respond in a more timely manner to audit questions and challenges

We have identified a number of adjustments to the accounts, some affecting the Council's reported financial position (details are recorded in section two of this report). The draft financial statements for the year ended 31 March 2017 recorded net expenditure of £131.9k. The net expenditure in the audited financial statements is £128.3m. Further details are set out in section two of this report.
As highlighted on page 5, there are still some material matters in the accounts. It is our expectation that these will be resolved to our satisfaction and then we will provide a unqualified audit opinion in respect of the financial statements (see Appendix B).

Other financial statement responsibilities

As well as an opinion on the financial statements, we are required to give an opinion on whether other information published together with the audited financial statements is consistent with the financial statements. This includes if the Annual Governance Statement (AGS) and Narrative Report is misleading or inconsistent with the information of which we are aware from our audit.

Based on our review of the Council's Narrative Report and AGS we are satisfied that they are consistent with the audited financial statements. We are also satisfied that the AGS meets the requirements set out in the CIPFA/SOLACE guidance.

CIPFA's intention, based on FRC principles, is that the Narrative Report should provide an overall summary of the key features of the financial statements that follow and provide a forward financial view, putting the financial statements into context. The draft Narrative Report provided at audit did not meet all of the requirements of the Code. The Council's Accounts Foreword could be enhanced by reference to key events or developments of a financial significance arising during the year: for instance, a more detailed explanation of the Council's success in delivering the challenging savings targets; commentary around the budget outturn and challenges facing specific services, such as children's services or adult social care. We would also have expected the Foreword to refer to material balance sheet movements relating to PPE, for instance the inclusion of a £33.4m asset for the energy to waste plant and the material reclassification of investment property assets. No reference was made to the inclusion of Hoople pension liabilities within the statement of accounts for the first time this year, although these have subsequenty been excluded from the accounts.

Controls

Roles and responsibilities

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.

Findings

Our work has not identified any control weaknesses which we wish to highlight for your attention.

Further details are provided within section two of this report.

Value for Money

Based on our review, we are satisfied that, in all significant respects, the Council had proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources.

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

Other statutory powers and duties

We have not identified any issues that have required us to apply our statutory powers and duties under the Act.

Other matters

We cannot formally conclude the audit and issue an audit certificate in accordance with the requirements of the Act and the Code until we have:

- completed the work necessary to issue our Whole of Government Accounts (WGA) Component Assurance statement for the Authority for the year ended 31 March 2017, and
- completed our consideration of other matters brought to our attention by the Authority.

The WGA work will be completed by the deadline set by the national audit office, in September.

Grant certification

In addition to our responsibilities under the Code, we are required to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. At present our work on this claim is in progress and is not due to be finalised until 30 November 2017. We will report the outcome of this certification work through a separate letter to the Committee which is due in February 2018.

There is some cross-over between the audit procedures undertaken on the main audit and the housing benefits audit. There are no matters of concern arising from our benefits audit to date.

The way forward

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

We have made a number of recommendations, which are set out in the action plan at Appendix A. Recommendations have been discussed with the Chief Finance Officer and the finance team and reflect their responses.

Acknowledgement

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 2017

Section 2: Audit findings

Materiality

In performing our audit, we apply the concept of materiality, following the requirements of ISA (UK&I) 320: Materiality in planning and performing an audit. The standard states that 'misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements'.

As we reported in our audit plan, we determined overall materiality to be £6.6m (being 1.8% of gross revenue expenditure). We have considered whether this level remained appropriate during the course of the audit and reduced it to £5.9m to reflect the lower gross expenditure at the outturn, being 1.8% of gross revenue expenditure.

We also set an amount below which misstatements would be clearly trivial and would not need to be accumulated or reported to those charged with governance because we would not expect that the accumulated effect of such amounts would have a material impact on the financial statements. We have defined the amount below which misstatements would be clearly trivial to be £295k.

As we reported in our audit plan, we identified the following items where we decided that separate materiality levels were appropriate. These remain the same as reported in our audit plan.

Balance/transaction/disclosure	Explanation	Materiality level
Related Party Transactions	Due to public interest in these disclosures and the statutory requirement for them to be made.	£20k
Disclosures of officers' remuneration, salary bandings and exit packages in the notes to the financial statements	Due to public interest in these disclosures and the statutory requirement for them to be made.	£20k

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered. (ISA (UK&I) 320)

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Audit findings against significant risks

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
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Herefordshire Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including Herefordshire Council, mean that all forms of fraud are seen as unacceptable.	Our audit work has not identified any issues in respect of revenue recognition.
Management over-ride of controls Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.	• review of journal entry process and selection of unusual journal entries for testing back to supporting documentation • review of accounting estimates, judgements and decisions made by management • review of unusual significant transactions.	Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal 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 judgements.

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, due to either 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 (UK&I) 315) . In making the review of unusual significant transactions "the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks." (ISA (UK&I) 550)

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Audit findings against significant risks continued

Risks identified in our audit plan	Work completed	Assurance gained and issues arising
Valuation of property, plant and equipment (PPE) The Council revalues its assets on a rolling basis over a five year period. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from the current value. This represents a significant estimate by management in the financial statements.	• **Review of management's processes** and assumptions for the calculation of the estimate. • Review of the competence, expertise and objectivity of any management experts used. • Review of the instructions issued to valuation experts and the scope of their work • Discussions with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions. • Review and challenge of the information used by the valuer to ensure it was robust and consistent with our understanding. • Testing of revaluations made during the year to ensure they were input correctly into the Council's asset register • Evaluation of the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value.	**Assets not valued in year:** Under the Code, assets should be revalued in a 'short period'. Most authorities meet this requirements through a 5 year rolling programme with additional valuations being requested where there has been a known change in circumstances. There is however an overriding requirement of the Code to ensure that the carrying value is not materially different to current value at each year end, of the entire portfolio. The Council's accounting policy refers to an annual review to meet this requirement. To meet this requirement, the Council asks Hub (the expert) for support by providing an evaluation of the change in value of particular classes of assets. At the interim stage of the audit, officers provided a working paper applying the percentages indicated across the classes of assets. When applied to assets not revalued in year, it indicated a material movement in the value of assets not revalued. Analysing the movements, we informed officers that they should either adjust the accounts or get the view of a valuation expert as to whether the movement in values in relation to schools (one of the higher-value areas of PPE) might be less than the material difference identified by HUB, to avoid the need undertake additional valuations. This matter has not yet been resolved to our satisfaction. **PPE testing:** Incorrect versions of valuation schedules were initially provided to support the PPE revaluations reflected in the asset register. Later versions did not contain sufficient information to support the change in value or classification of some of the assets we selected for testing , so that further explanations from the valuer had to be sought. Errors were identified from our testing, one amounting to some £14m and officers have agreed to adjust for these errors. Some of these errors should have been identified by the Finance Team's own quality review processes; by challenge of the information provided by the valuer and through questioning unusual movements in balances in the draft accounts before being presented for audit. **Agricultural properties:** The Council has made the policy decision that retention of the stock for current purposes is no longer a strategic priority. In April 2017 £2m of assets were marketed for sale , the deadline for bids was July 17 and completion is expected by the calendar year end. They are marketed for £35m. At interim audit we were told that these assets would be reclassified as assets held for sale and valued accordingly. In the accounts they remain as operational assets. No marketing took place until April 2017 and so reclassification as assets held for sale would not be appropriate. The remaining £6.5m are not being marketed due to their development potential, although they continue to be let with ongoing tenancies in place at the year end. Two of the properties have planning permission for industrial use. These continue to be classified and valued as operational properties. There was no reference to this matter in the draft accounts. The classification and valuation is unchanged from the previous years. The assets were last valued on 1 April 2013 prior to the Council decision on the future of these assets. We sought evidence to support the Council's judgement that the assets classification and valuation remained current in 2017, in view of the time elapsed from the original valuation, the policy decision and the marketed value of the assets. A judgement could have been made that reclassification as surplus or investment properties may more properly reflect the use and purpose of these assets and this would impact on the valuation of these assets. Officers argued that these assets remained operational properties because they all had on-going tenancies at the year end. Evidence was not provided to support this until August 2017, following an initial request in April 2017. We considered that this was a critical accounting judgement in the accounts and should be disclosed. Officers were initially reluctant to accept that this was in a critical judgment, the basis of which should be explained, but has now been included in the accounts. We have also received a draft 'non adjusting post balance sheet event' disclosure to reflect this significant event after the year end.

Audit findings against significant risks continued

Risks identified in our audit plan	Work completed	Assurance gained and issues arising
Valuation of pension fund net liability The Council's pension fund net liability, as reflected in its balance sheet ,represents a significant estimate in the financial statements.	• Identifying the controls put in place by management to ensure that the pension fund net liability is not materially misstated and assessing whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement. • Review of the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation. • Gaining an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made. • Review of the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary.	We are satisfied that the actuary is appropriately qualified to undertake the work for Herefordshire Council. In considering the actuarial assumptions we have considered the views of our 'Auditors expert' PWC on the broad approach adopted by the actuary. In addition we have sought assurance from the auditor of the Pension fund administrator on the adequacy of their arrangements. No matters of concern have arisen from these enquiries. We have also considered the basis for any local assumptions referred to in the Mercers report and those stated in the accounts. Within the Mercers report there is reference to inclusion of Hoople Ltd pension assets within their ISA19 figures. There is no information provided on the values. Prior to this year, inclusion of Hoople assets and liabilities was up to the point of transfer of staff to Hoople from Herefordshire Council. This new assumption indicated that amounts accrued since this point were now also included. No reference to this has been made in the draft accounts. We requested evidence from officers to support this new assumption and the financial impact. We suggested that the Council should consult with its actuary to obtain this information. Whilst this matter has been with officers for many months, it has yet to be resolved to our satisfaction. We are awaiting the final position on this before we are able to complete our work on IAS19 disclosures. We do not have enough information to make a judgement as to the financial impact of this matter on the Councils accounts is material or not, nor on the lawfulness of the approach. This remains an uncertainty and could impact on our opinion on the accounts.

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
Employee remuneration	Payroll expenditure represents a significant percentage of the Council's gross expenditure. We identified the completeness of payroll expenditure in the financial statements as a risk requiring particular audit attention: • Employee remuneration accruals understated (Remuneration expenses not correct)	We have undertaken the following work in relation to this risk: • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • tested a sample of employees costs to underlying records. • Reviewed the trend analysis • Review of reconciliation	No matters of concern have arisen in relation to this risk. There was one contract of employment that had not been signed in the sample tested We did however find that obtaining the trend data in the correct format and evidence to support some of the employee pay rates was difficult to obtain. This may be because there were new members of the payroll team. We will work with your officers to make sure that they understand audit requirements and that we are able to finalise the majority of this work at interim, reducing the risk of not delivering an early opinion in 2017/18.
Operating expenses	Non-pay expenditure represents a significant percentage of the Council's gross expenditure. Management uses judgement to estimate accruals of un-invoiced non-pay costs. We identified the completeness of non- pay expenditure in the financial statements as a risk requiring particular audit attention: • Creditors understated or not recorded in the correct period (Operating expenses understated)	We have undertaken the following work in relation to this risk: • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • Tested interfaces with subsidiary ledger • Understood the process for year end accruals and tested a sample • Undertaken cut off testing • Completion of substantive testing for a sample of operating expenses.	No matters of concern have arisen in relation to our testing of operating expenses, including our review of the particular risk around creditors. We are awaiting further information to support the remaining to creditor items. We noted that the Council intends to increase the amount below which items are not accrued from £25k (applied in 16/17) to £100k in 2017/18. Our testing did not identify significant amounts not accrued in 16/17 and thus an increase to the deminimus is reasonable, particularly in view of the pressures for earlier close. The Council will need to demonstrate that increasing to £100k will not result in a material cut-off error and we will consider evidence to support this at our interim visit. We experienced some difficulty getting appropriate back up information to support our sample testing. Again, we will work with your officers to ensure that there is a better understanding of audit requirements and some quality control in place so that the work can be completed more quickly in 2017/18.

"In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them." (ISA (UK&I) 315)

Audit findings against other risks continued

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Changes to the presentation of local authority financial statements	CIPFA has been working on the 'Telling the Story' project, for which the aim was to streamline the financial statements and improve accessibility to the user and this has resulted in changes to the 2016/17 CIPFA Code of Practice. The changes affect the presentation of income and expenditure in the financial statements and associated disclosure notes. A prior period adjustment (PPA) to restate the 2015/16 comparative figures is also required.	We have undertaken the following work in relation to this risk: • documented and evaluated the process for the recording the required financial reporting changes to the 2016/17 financial statements • reviewed the re-classification of the Comprehensive Income and Expenditure Statement (CIES) comparatives to ensure that they are in line with the Council's internal reporting structure • reviewed the appropriateness of the revised grouping of entries within the Movement In Reserves Statement (MIRS) • tested the classification of income and expenditure for 2016/17 recorded within the Cost of Services section of the CIES • tested the completeness of income and expenditure by reviewing the reconciliation of the CIES to the general ledger • tested the classification of income and expenditure reported within the new Expenditure and Funding Analysis (EFA) note to the financial statements • reviewed the new segmental reporting disclosures within the 2016/17 financial statements to ensure compliance with the CIPFA Code of Practice.	We have not yet received a 'final' draft version of the financial statements and therefore this work is not yet complete. The accounts presented were not compliant with the new code requirements and a number of audit adjustments have been made to primary statements. The overarching principle of the 'telling the story' project is to simplify the accounts and to provide a better link to the in year reporting and this had not been achieved in the first draft of the accounts. Material changes had been made to the prior year restatement which we considered at interim to the final version presented for audit. Officers were reluctant to accept that the accounts were not presented in line with the code and thus resolution of this matter was protracted. Had better consideration of the code taken place in drafting the accounts this could have been avoided. Specifically: **CIES:** this has been restated as items had been included within a corporate line when the costs were attributable to service heads. **MIRS:** most councils are changing the presentation of the MIRS to simplify it. Herefordshire has chosen not to, with the format remaining the same as in 15/16. This is acceptable under the Code although the Council should have included a total column after the General Fund and Earmarked reserves columns to show the total General Fund Balance in order to meet the Code requirement in para 3.4.2.55. This is key to the new Expenditure and Funding Analysis (EFA). There should also be a note supporting the *adjustments between accounting basis and funding basis under regulations*. This is included in other councils financial statements and the consequence for Herefordshire is that the cross reference on the MIRS does not explain the movement clearly and additional notes have been added to the EFA. This all makes the statements difficult to follow.

Audit findings against other risks continued

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Changes to the presentation of local authority financial statements (continued)			**A prior period restatement** note was not included which is a code requirement. **Expenditure and Funding analysis:** This was not presented in line with the Code, nor did it correctly balance with the MIRS. The Code makes clear that the accounts should introduce the EFA to explain its purpose to the user of the accounts. No introduction was provided. **Other matters:** The primary financial statements did not include any cross reference to the supporting notes, making it almost impossible for the user of the accounts to navigate the financial statements. As part of the drafting the accounts, we ask officers to complete the SORP disclosure checklist. This had been completed and indicated that the accounts were compliant in all areas. This evidently was not the case and we would recommend that in future years this is completed by a more senior member of staff as part of the quality review process.

Audit findings against other risks continued

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Welfare benefit expenditure	Welfare benefit expenditure represents a significant percentage of the Council's gross expenditure. We identified welfare benefit expenditure as a risk requiring particular audit attention: • Welfare benefit expenditure improperly computed	We have undertaken the following work in relation to this risk: • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • Undertaken substantive testing for a sample of benefits payments • Undertaken analytical review • Undertaken work to confirm that the correct version of software is being used and correct parameters are in place	No matters to report

Going concern

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK&I) 570).

We reviewed the management's assessment of the going concern assumption and the disclosures in the financial statements and concluded that this assumption is appropriate

New issues and risks identified during the course of the audit

This section provides commentary on new issues and risks which were identified during the course of the audit and were not previously communicated in the Audit Plan

	Issue	Commentary
1.	**Energy from waste plant** The Council has in conjunction with Worcestershire Council, developed an Energy From Waste (EFW) plant through a PFI arrangement. Worcestershire County Council are the lead on this project.	• The plant was completed in the financial year and £33.4m was included as additions within note 15 reflecting Herefordshire Council's 'interest' in the asset. There is some reference to the project in the leases note and a reference to the £11.4m loan in the narrative foreword. No specific reference is made to the £33.4m asset anywhere in the accounts, although it is highly material and significant project. • The Code is clear that the asset should be included in the accounts at fair value. This could be achieved through a valuation or by reference to invoices paid. The Council has not been able to demonstrate that the value relates to invoices raised nor has a valuation been undertaken. The need to comply with code requirements was raised by Grant Thornton with Worcestershire CC at interim. Worcestershire CC has commissioned a valuation during w/c 28 August 2017. This is likely to impact on the valuation of the asset and thus the share reflected in Herefordshire Council's financial statements. • We will be unable to issue an opinion on the accounts until this matter is resolved.
2	**Narrative report** We are required to give an opinion on whether other information published together with the audited financial statements is consistent with the financial statements.	• No evidence has been provided to support the statement that 'The 2016/17 accounts demonstrate financial robustness with reserves proportionately comparable to similar Councils' and so we are unable to express a view on the accuracy of this statement. Reference to balances compared to the CFO's stated judgement of the minimum level of balances would be an appropriate reference. • The pension deficit is a key challenge for all Councils however the paragraph does not adequately explain the position in Herefordshire (e.g. reducing deficit contributions and by the employer but this will eliminate the deficit over a shorter time period). This paragraph appears to be the prior year paragraph with this year's information inserted. It does not adequately inform the reader. This will have been impacted by the full actuarial review which took place this year and should have been better explained. No reference is made as to the impact of inclusion of Hoople liabilities and why this has been done.

Significant matters discussed with management

On 27 July 2017 a report was presented to Cabinet, updating on the Joint Customer Services Hub. The report highlights that there is a large projected overspend on the scheme with anticipated costs of £1.92m compared to £0.9m, as approved in June 2016. A recommendation is made for the Audit and Governance Committee to identify and recommend improvement actions to strengthen property capital management, and Internal Audit are supporting this review.

We discussed with officers whether there was a need to reflect this position in the accounts, but we agreed it was not sufficiently material to be reflected as a capital commitment or post balance sheet event. However it is a matter that could be referred to in the Narrative Report. No changes have been made to the Narrative Report.

All other significant matters discussed with management are already outlined within this report. There were no other significant financial or legal matters discussed in the course of the audit.

Accounting policies, estimates and 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	• Revenue and capital transactions are accounted for on an accruals basis where above the de-minimus thresholds • Government grants and other contributions are recognised where reasonable assurance has been gained that the Council will comply with relevant terms and conditions and it is likely the amounts will be received • Income receivable from the sale of good and rendering of services is recognised in line with the relevant conditions • Collection fund income is recognised on an accruals basis	• No maters arising in relation to the adequacy and appropriateness of the disclosed revenue recognition policies. • Adequate disclosure has been made around key income sources including fees and charges and NNDR and council tax.	green
Judgements and estimates	• Key estimates and judgements include: – Useful life of PPE – Revaluations – Impairments – Accruals – Valuation of pension fund net liability – Provision for NNDR appeals – Other provisions	**Accounting policy:** • PPE Revaluations: the stated accounting policy has not been adequately applied in the draft accounts presented for audit because there was evidence of a material movement in the value of assets that had not been reflected in the accounts. • Accruals of income and expenditure refers to accruals being included above the deminimus, but the deminimus level is not stated. No level is stated for PPE capitalisation. **Assumptions made about future and major sources of estimation uncertainty**; All items should really contain a financial indication of the impact of a change in the financial assumption on the accounts	amber

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

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Accounting policies, estimates and judgements continued

.

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates (cont)	• Key estimates and judgements include: – Useful life of PPE – Revaluations – Impairments – Accruals – Valuation of pension fund net liability – Provision for NNDR appeals – Other provisions	**Critical judgment disclosures:** The critical judgement should describe the nature of the critical judgement rather than referring to the areas – e.g. the reference to the leases where the Council has used its judgement No reference is made to judgements around schools (e.g. accounting treatment of the schools' land and buildings and consolidation of school activities An additional critical judgement has been made at audit request on the Classification of agricultural properties We have assessed this section as amber, to reflect the draft accounts were not adequate in our view. We are satisfied that, subject to the comments above, appropriate disclosures are now made in the accounts.	amber
Going concern	The Chief Finance Officer s151 officer has a reasonable expectation that the services provided by the Council will continue for the foreseeable future. Members concur with this view. For this reason, the Council continue to adopt the going concern basis in preparing the financial statements.	We have reviewed the Council's assessment and are satisfied with management's assessment that the going concern basis is appropriate for the 2016/17 financial statements.	green
Other accounting policies		We have reviewed the Council's policies against the requirements of the CIPFA Code of Practice. The Council's accounting policies are appropriate and consistent with previous years.	green

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

Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

	Issue	Commentary
1.	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the Audit Committee. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures
2.	**Matters in relation to related parties**	• From the work we carried out, we have not identified any related party transactions which have not been disclosed.
3.	**Matters in relation to laws and regulations**	• You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
4.	**Written representations**	• A standard letter of representation has been requested from the Council • Specific representations have been requested from management in respect of the significant assumptions used in the ongoing tenancies assumption for agricultural properties
5.	**Confirmation requests from third parties**	• We have not mad any specific confirmation requests from third parties.
6.	**Disclosures**	• We have highlighted areas of non compliance with the code and omissions from the accounts with officers. They have agreed to make enhanced disclosures in all material areas, although there are some areas where presentation could be further enhanced in line with best practice.

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Other communication requirements continued

	Issue	Commentary
7.	**Matters on which we report by exception**	There are no matters to report be exception
8.	**Specified procedures for Whole of Government Accounts**	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. If the Council exceeds the specified group reporting threshold of £350k we examine and report on the consistency of the WGA consolidation pack with the Council's audited financial statements. • Note that work is not yet completed but will be completed by the deadline set by the NAO

Internal controls

The controls were found to be operating effectively and we have no matters to report to the Audit Committee

"The purpose of an audit is for the auditor to express an opinion on the financial statements.

Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance." (ISA (UK&I) 265)

Adjusted misstatements at date of drafting we have not reviewed all the adjustments made to the accounts or the supporting working papers and thus some items are 'to be confirmed' as indicated) (TBC)

A number of adjustments to the draft accounts have been identified during the audit process. We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts 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 in detail below along with the impact on the key statements and the reported net expenditure for the year.

	Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £'000	Impact on total net expenditure £000
1	PPE: note 10: investment assets (£3.9m impairment should be revaluation of £0.2 (see item 1 page 27)	tbc	tbc	tbc
2	PPE: note 10 investment assets (£14.3m impairment rather than reclassification) (see item 2 page 27)	tbc	-£14.3m	tbc
3	EFA restatement: see item 12 page 30	tbc	tbc	tbc
4	CIES restatement (see item 13 page 30) – reclassification between lines – no impact on totals	£67m exp £47.7m income	n/a	£nil
	Overall impact		**£4.8m tbc**	**£3.6m tbc**

Unadjusted misstatements

The table below provides details of adjustments identified during the audit which have not been made within the final set of financial statements. We ave also made recommendations for further disclosures to be made which do not impact on the numbers themselves and these are referred to on page 27) The Audit Committee is required to approve management's proposed treatment of all items recorded within the table below:

	Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £'000	Reason for not adjusting
1	Item 3 page 27. Discrepancy between asset register and Valuation certificates	n/a	£0.3m understatement	Not considered material to investigate further
2	PPE: item 6 page 28: discrepancy between the asset register and the accounts	Up to (£0.7m)	(£0.7m) £0.3m	Not considered material to investigate further
3	Item 20 page 31: grant income overstated – impact on notes 28 and 11 £1.2m	n/a	n/a	Not considered material to investigate further
	Maximum Overall impact	£0.7m	£0.7m	

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Misclassifications and disclosure changes

The table below provides details of misclassification and disclosure changes identified

	Adjustment type	Value	Account balance	Impact on the financial statements
1	Misstatement (adjusted, not yet reviewed)	£3.9m	PPE: note 10 Investment assets	Our sample included an impairment of £3.9m on an investment asset. We queried this and following consultation with the valuer was identified as an error. Rather than an impairment there is an upward revaluation of £0.2m which is to be adjusted for. This is reflected in the revised accounts however the associated journals are not yet available for us to review. This will impact on various statements including balance sheet and CIES
2	Misstatement (adjusted, not yet reviewed)	£14.3m	PPE: note 10 Investment assets	**Rotherwas Industrial Estate:** the draft accounts reflect an in year transfer of £14.3m of Investment properties to Infrastructure assets. We queried this as the reason for the re-classification was not evident from the valuation statement, and officers were unable to supply any explanation for the accounting treatment. This movement was highlighted as unusual in our initial review of the accounts due to the relative size, the expectation that this type of reclassification would normally require a revaluation (as investment and infrastructure assets have a different valuation basis) and whether this was as a consequence of an event in the year or an error in a prior year (which would require a prior period restatement). This matter took considerable time to resolve but the outcome is that this was incorrectly reclassified and should have been accounted for as an impairment in year. We again queried this as the asset was valued at £21m and was being impaired to £7.3 which is considerable for such an asset. Officers requested further information from the valuer who confirmed that this value reflected the uncertain conditions following Brexit and officers accept this explanation as reasonable. This impairment will impact on primary statements and we have yet to review the entries, although these are reflected in the revised accounts.
3	Misstatement (unadjusted)	£0.367m	PPE: note 10 Investment properties	The valuer has provided a spreadsheet reflecting his valuation of assets. There are some discrepancies between this and the asset register as follows:. • *Hereford New Livestock Market, Roman Road*, The value in the asset register is: £1,270,001, The valuation per the spreadsheet is£1,948,000, £677,999 lower than the valuer's amount. • *Rotherwas Industrial estate* The value in the asset register is: £7,321,500. The valuation as per the spreadsheet is £7,010,798. The Asset register is £310,702 higher than the valuer's amount. The net effect on the asset register and hence the accounts is £367,297 lower than the valuers report. Reported here as above trivial.

Misclassifications and disclosure changes

The table below provides details of misclassification and disclosure changes identified

	Adjustment type	Value	Account balance	Impact on the financial statements
4	Disclosure (unadjusted)	£40.7m	Long term debtors/ Financial instruments	Long term debtors have increased from £27.1m to £40.7m. (£8.9m 2014/15 . Included in this total, is an amount of £35.8m which relates to a Loan to Mercia Waste Management (re Waste Incinerator PFI). Whilst total long term debtors are disclosed on the face of the balance sheet and within note 11 (financial instruments), and there is some reference to the loan arrangement under PFI disclosures, given the significance of this item, we proposed that the Council include a separate disclosure note specifically for this item. This was also a recommendation made in 15/16. (long term borrowing also impacted)
5	Disclosure (unadjusted)	£560.6	Note 10: Property Plant and equipment	Note 10 – is headed Fixed assets correct terminology under the code is property plans and equipment
	Disclosure (unadjusted)	£33.5	Note 10: Property Plant and equipment	Note 10 and note 32 – no reference to PFI asset additions in year – would expect specific reference (was included in 15/16) and it should be included n the assets table in this note. There is no reference in the accounts that the asset became operational this year – in fact the reference in note 32 implies it is not yet complete.
6	Misstatement (unadjusted)	£0.7m and £0.3 m	Note 10: Property Plant and equipment	There are two amounts in note 10 which do not agree to the fixed asset register, these are: Buildings: Impairment Losses shown in note 10 as £3.1m and revaluation is £7.2m. The asset register shows these figures to be £2.4m and £6.9m respectively creating a difference of £0.7m and £0.3m respectively between the accounts and the supporting working papers (asset register).
7	Disclosure (unadjusted)	£various fair value disclosures	Note 11: Financial Instruments	In the previous year we highlighted that the fair value calculation of PWLB loans, bank loans and loan with other local authorities was disclosed using the early repayment method which is no longer applicable under the Code. The disclosure was updated to reflect the new loan rate. However in the 2016/17 accounts there is reference to both the new loan rate and the premature repayment rate. Any reference to the premature repayment rate should be removed.

Misclassifications and disclosure changes

The table below provides details of misclassification and disclosure changes identified

	Adjustment type	Value	Account balance	Impact on the financial statements
8	Misstatement (unadjusted)	£0.3m	Note 14	The cash flows for operating activities included the following adjustment for non-cash movements shows for the line depreciation, amortisation & impairment of non-current assets £26.1m. Deprecation is shown in note 15 as £16.2m, the remainder being reconciled to the supporting evidence to the MIRS, although there is a discrepancy of £0.3m. It is not clear the source of the imbalance and we have not asked officer to resolve due to the relative immateriality, although it is reported here as it is above trivial.
9	Misstatement (unadjusted)	£0.4975	PPE: note 10	Our testing of PPE incudes a test of ownership. We checked one asset: Walford school and understand that there is an ongoing dispute with the Land Registry around the land, dating back to the original deed of 1882. The Council does not technically own the land that the school sits on, even though they do own the school building and the land adjacent to the school. The value of the land is included in total PPE. We accept that it is not appropriate to adjust for this as the matter is unresolved.
10	Disclosure (unadjusted)	£1.7m	PPE note 10	Hereford Governors House Union Walk: Value as at prior year was £1.7m, now valued at £1,700. As per the Asset register this has created an impairment of £1.7m. The valuation certificate has been checked and it confirms that the value is £1,700, review of the valuation certificate shows that in the prior year the value was also £1,700. Therefore the impairment which has been included in the 2016/2017 year is a correction of the prior year where the valuation has been included as £1.7m instead of £1,700. This item was selected for testing and finance staff were unaware of the reason for the impairment, and was referred to the y the valuer for clarification. The accounting treatment is appropriate to adjust for an error in prior year accounts as it is not material and thus a PPA is not required. No specific reference is made to this in the accounts as it was not considered to be significant.

Misclassifications and disclosure changes

The table below provides details of misclassification and disclosure changes identified

	Adjustment type	Value	Account balance	Impact on the financial statements
11	Misstatement/ disclosure (adjusted)	£369k expenditure £200k income	Prior period adjustment CIES	The draft accounts did not include a note, as indicated in the code, to reflect the restatement of 2015/16. The revised draft did not agree to the prior year statements (gross or net) and were restated
12	Misstatement (adjusted)	tbc	EFA	The note presentation was not compliant with the code requirements. The revised draft was still not correct and was redrafted because: • The column net chargeable to the general fund did not reflect revised code requirement that the total general fund reflects both earmarked ad general fund balances and correctly reconcile to the MIRS i.e. reflecting a key feature of the 'Telling the Story' changes to the Code of Practice on local authority accounting. • The adjustments between funding and accounting basis and accounting basis did not agree to the MIRS
13	Disclosure (unadjusted)	£5.2m	MIRS/ EFA	The adjustments between funding and accounting basis is not supported by a separate note
14	Misstatement (adjusted)	£67m expenditure £47.7m income	CIES	Transferred to Economies, communities and corporate amounts that more appropriately is classified as income and expenditure under that heading, rather than corporate. Corporate line removed form the accounts and this now more reasonably reflects the segmental analysis required under the ‘telling the story’ changes to the code.
15	Disclosure (unadjusted)	£270,600	Related parties disclosure	Herefordshire have paid £270,600 to SWAP for internal audit work. The Chief Finance Officer (Andrew Lovegrove) is the Council's representative on SWAP. This is not disclosed within Note 24 as reported in 2015-16.
16	disclosure (un adjusted)	accounting policy	Note 23: Pooled budgets	An accounting policy has been added but no additional narrative to note 23 to clarify which elemest go through Herefordshire Council accounts
17	Misstatement (adjusted)		Note 23: Pooled budgets	The minimum revenue fund, capital pool, and additional revenue pool did not include prior year comparators. This is a standard requirements that all notes should contain prior year comparators.

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Misclassifications and disclosure changes

The table below provides details of misclassification and disclosure changes identified

	Adjustment type	Value	Account balance	Impact on the financial statements
18	Misstatement (adjusted)	£3.5m	Note 30: capital expenditure and capital financing	The following figures need to be changed in the Capital Expenditure and Capital Financing note: The figure for the PFI should be £11.4m and not £14.9m (investment) and the figure for Government grants and other contributions should be £30.1m and not £33.6m. (source of finance)
19	disclosure (adjusted)	numeric	Note 24:Officer remuneration	Employees on £50k+. Draft accounts total – 103 amended to 104 Some incorrect allocation of bandings Some incorrect split of termination benefits
20	misstatement (unadjusted)	£1.2m	Note 28: grant income	Note 28 to the accounts shows the grants which are credited to services. The department of Work and Pensions line represents the grant from the DWP in respect of benefit subsidy. Included in this amount is £1.258m for benefit overpayments, The note is £1.258m overstated. This also means that note 11 is overstated on the Government grants and contributions line by £1.258m. Given the other headings it appears reasonable that this should go in the fees, charges and other service income line.
21	Disclosure (unadjusted)	narrative	Annual governance statement	The AGS should make reference to the audit certificate remaining open for 2015/16
22	Disclosure (unadjusted)	narrative	Accounting policy: Interests in Companies and Other Entities	page 32 - interests in companies - states that Herefordshire Council has a 85% shareholding. Per companies house Herefordshire Council has a 71% shareholding
23	Disclosure (adjusted)	£3.6m	Note 11, note 40, note12	Reference is made to bad debt 'provisions. ' Under the code debtors as financial assets are subject to 'impairment'. Also each class of debtor in note 12 should be shown at its recoverable amount. Code para 5.3.4.2. If the Council wish to show impairments, then it should show the class of debtor less impairment then total of that class.

Section 3: Value for Money

Background

We are required by section 21 of the Local Audit and Accountability Act 2014 ('the Act') and the NAO Code of Audit Practice ('the Code') to satisfy ourselves that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VFM) conclusion.

We are required to carry out sufficient work to satisfy ourselves that proper arrangements are in place at the Council. The Act and NAO guidance state that for local government bodies, auditors are required to give a conclusion on whether the Council has put proper arrangements in place.

In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in November 2016. AGN 03 identifies one single criterion for auditors to evaluate:

> *In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

AGN03 provides examples of proper arrangements against three sub-criteria but specifically states that these are not separate criteria for assessment purposes and that auditors are not required to reach a distinct judgement against each of these.

Risk assessment

We carried reported to you the outcome form our initial risk assessment in March 2017 and identified two significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated March 2017.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work.

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.

Significant qualitative aspects

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risks that we identified in the Council's arrangements. In arriving at our conclusion, our main considerations were:

- Health and Social Care integration
- Financial sustainability

In common with many health and social care economies, integration continue to present considerable operational and financial challenges. Whilst this is also the case in Herefordshire we consider that the Council and its partners are taking reasonable steps to manage local arrangements in this challenging environment

It is well reported that the Council has to achieve considerable savings within the lifetime of the medium term financial plan. Nationally councils are struggling and this is reflected in increasing numbers of qualifications to vfm conclusions. We are satisfied that Herefordshire is planning appropriately and delivering the savings that it needs to achieve its MTFP.

Overall conclusion

Based on the work we performed to address the significant risks, we concluded that:

- the Council had proper arrangements in all significant respects to ensure it delivered value for money in its use of resources.

The text of our report, which confirms this can be found at Appendix B.

Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

Significant risk	Work to address	Findings and conclusions
Health & Social Care Integration The Council is seeking to deliver wide ranging changes and greater integration to ensure the financial sustainability of adult health and social care services. Working with partners from different organisations and service areas with potentially conflicting priorities, the project is complex and high profile.	We will follow up progress that the Council is making in relation to the 'One Herefordshire' plan.	**We have concluded that the Council and its partners are making progress in achieving transformation. During the year there has been focus on developing the Sustainability and transformation Plan (STP) across the Herefordshire and Worcestershire foot print. Priorities and work streams have been revisited and build on the One Herefordshire plan.** The STP process has prompted a refresh of the 'One Herefordshire' plan. There are now clearer priorities and expected outcomes of the STP / One Herefordshire process. It is still early in the implementation of the STP and it is still out to consultation, although work is progressing with some of the identified work streams, for example around urgent care. There has been some focus this year on strengthening governance arrangements. around these work streams. It is too early to assess how effective those arrangements are in practice. The Joint Commissioning Board (as part of the Better Care Fund Framework) and Health and Wellbeing Board specific areas. We do note that there is little representation by the providers in these forums. The partners have yet to finalise the Better Care Fund targets and budgets for 2017/18, which is indicative of the local pressures. Health partners are facing considerable financial pressures and operational challenges, including turnover of key senior management over the last year, making successfully progressing integration a challenge. This will be a continuing risk for the partners for the foreseeable future. Despite this, we consider that sufficient progress has been made this year for the risk to be sufficiently mitigated to not be a matter for the VFM conclusion.

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Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

Significant risk	Work to address	Findings and conclusions
Financial sustainability The Council has a challenging target of delivering £87m of savings between 2010 and 2020. Significant progress has been made towards delivering this target with an anticipated £69.5m of these savings to be achieved by 2016/17. As at January 2017 the Council is forecasting a moderate overspend of £250k. The 2017/18 budget (and update to MTFP) includes some changes in assumptions. The budget monitoring reports in year contain a number of variations on a detailed directorate report level.	We will gain an understanding of the financial settlement impact and the Council's response to it and what arrangement the Council has in place to remain financially sustainable in the medium to long term.	**We have concluded that the Council is financially sustainable for the foreseeable future.** The out-turn report for 2016/17 indicates that the Council achieved a moderate underspend against the revised budget for 2016/17. This budget incorporates planned savings of around £10m and thus is a fantastic achievement this year, particularly when considered in the context of the deficit positions of the Council's local NHS partners. The out-turn position reflects a relatively small overspend on children's wellbeing. 2017/18 monitoring reports indicate increases in the number of looked after children not previously reflected in the budget resulting in a forecast overspend for the year. This remains a continuing financial pressure, despite increased efforts made by the Council to reduce the number of children in care. The level of savings to be achieved by 2019/20 is broadly in line with the prior year medium term financial plan, reflecting the achievement of 2016/17 targets and the impact of the 2017/18 financial settlement. The remaining £17.4m of savings are to be achieved by the end of 2019/20. We have considered how the Council is agreeing to and monitoring savings within the directorates. We have seen that targets have been 'signed up to' by service managers and monitored through 'savings cards' with risks to delivery being highlighted in in- year monitoring These arrangements are appropriate. Inevitably there is some virement of budgets between services and directorates during the year and as savings are embedded within budgets there would be improved transparency if reporting is further enhanced by reporting of year end savings out-turn at scheme level.

Significant difficulties in undertaking our work

As already outlined in our report, we experienced some difficulty in completing our audit work this year and this has resulted in the audit being protracted and being completed later than planned.

The audit could have been completed earlier had officers in the Council been more engaged in the audit and committed to resolving matters when raised.

Significant matters discussed with management

We sought specific representation on the basis of the significant judgements disclosure on agricultural properties. These properties are treated as operational within the accounts based on 2013 valuation because they have ongoing tenancies until the end of the calendar year. We have not seen adequate evidence to support the position on these tenancies and have therefore sought written confirmation from management that this is the case.

Having considered management's response we concluded that this assumption is reasonable.

Any other matters

As referred to earlier in the report, other significant matters discussed with management included the valuation of the PFI asset and other matters associated with the valuation of property plan and equipment.

We are hopeful that these matters will be resolved soon enabling us to issue an unqualified opinion on the financial statements by the statutory deadline.

Section 4: Fees, non-audit services and independence

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

Fees

	Proposed fee £	Final fee £
Council audit	124,405	TBC
Audit of subsidiary company: Hoople Limited (audit not yet complete)	14,780	TBC
Audit of subsidiary company/ joint committee west Mercia Energy prorate £4,333 to HUA	13,000	TBC
Grant certification: Housing Benefits indicative (audit not yet complete)	5,415	TBC
Total audit fees (excluding VAT)	**144,600**	**TBC**

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA) The final fee will be confirmed when our audit work is competed. Fee variations will be agreed with officers and PSAA.

Grant certification

Our fees for grant certification cover only housing benefit subsidy certification, which falls under the remit of Public Sector Audit Appointments Limited. Fees in respect of other grant work, such as reasonable assurance reports, are shown under 'Fees for other services'.

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 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.
- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table below summarises all non-audit services which were identified.

Fees for other services

Service	Fees £
Audit related services: Skills funding agency Teachers pension	 3,000 tbc
Non-audit services: Provision of advice to support HC procure a development partner to deliver schemes on a number of sites. An extension to this work was commissioned in 2017/18 and fees agreed are £12,000.	24,880
Hoople ltd; Tax compliance services to Hoople Ltd (not yet complete)	2,550

Please note that there is a discrepancy between these fees and those in Note 31 of the accounts as the accounts don't provide a separate disclosure of fees charged outside of the main external (PSAA) audit contract, as required by the Code. The advisory work is not included in the note to the accounts and the total audit fees in that note include Skills Funding Agency and the fee for the prior year teacher's pension.

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Independence and non-audit services

We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place

	Service provided to	Fees	Threat?	Safeguard
	Herefordshire Council	£24,800	N	Fees are not material to either Herefordshire Council or Grant Thornton and thus self- interest not considered a risk The proposed work is objective analysis and any decision will be made by management. No self-review, management or advocacy threat.
	Hoople Ltd – tax compliance	£2,550	N	Proposal for work considered and approved by our ethics team. The fee and the value of tax in the accounts is not material and so no self review self interest management or advocacy threat.
	TOTAL	£27,430		

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

Section 5: Communication of audit matters

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Communication to those charged with governance

ISA (UK&I) 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.

This document, The Audit Findings, outlines those key issues and other matters arising from the audit, which we consider should be communicated in writing rather than orally, 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 Public Sector Audit Appointments Limited (http://www.psaa.co.uk/appointing-auditors/terms-of-appointment/)

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 at the time of our appointment. 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 NAO (https://www.nao.org.uk/code-audit-practice/about-code/). 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		✓
Non compliance with laws and regulations		✓
Expected modifications to auditor's report, or emphasis of matter		✓
Unadjusted misstatements and material disclosure omissions		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern	✓	✓

Appendices

A. Action plan

Priority

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
1	Prior to the completion of the draft financial statements, senior officers should quality review the accounts including consideration of the Code of Practice and CIPFA LAAP bulletins. This will mitigate any risk of non-compliance with the disclosure requirements of the Code. This should be built into the closedown timetable. A similar recommendation was made in the 2015/16 AFR	high	Agreed – this will be added into the closedown timetable	Head of Corporate Finance May 2018
2	Officers should be more proactive in the commissioning of PPE valuation, ensuring that all relevant information is considered and shared with valuers as appropriate. Officers should review all changes for reasonableness prior to being reflected in the accounts. The cost of commissioning any valuations should not be a material consideration over ensuring compliance with code requirements.	medium	Agreed- an earlier programme will be agreed with the valuation experts following consultation with other councils.	Corporate Finance Manager April 2018
3	Officers should consider the good practice requirements of the code in relation to the narrative report in drafting the 2017/18 accounts. There are many good practice examples available. Rolling forward the prior year report and inserting this year's figures does not indicate that this matter has been given due consideration. As a minimum there should be better reference to important and significant transactions within the accounts, both in the narrative report and in supporting disclosures to notes to the accounts.	medium	The narrative report will be considered during the 2017/18 closedown process.	Chief Finance Officer 2018

Controls o
- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

A. Action plan

Priority

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
4	The accounts contain some material figures that are provided by third parties. This includes the IAS19 disclosures and information around PFI. Officers should ensure that they have considered the key assumptions made by third parties and can demonstrate that they have considered the reasonableness of all information provided.	medium	Agreed. Already in place and will continue.	Head of Corporate Finance 2018
5	In the 2016/17 AFR we recommended that a note should be included on the LEP showing transactions. This was not included.	low	Noted. Shropshire Council have expanded their publicly available LEP reporting.	

Controls

- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

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B: Audit opinion

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEREFORDSHIRE COUNCIL

We have audited the financial statements of Herefordshire Council (the "Authority") for the year ended 31 March 2017 under the Local Audit and Accountability Act 2014 (the "Act"). 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 2016/17.

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Act and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. 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 Finance Officer and auditor

As explained more fully in the Statement of Responsibilities, the Chief Finance 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 2016/17, which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law, the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the "Code of Audit Practice") 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 Finance Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Narrative Report, the Annual Governance Statement to identify material inconsistencies with the audited financial statements and to identify any information that 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 present a true and fair view of the financial position of the Authority as at 31 March 2017 and of its expenditure and income for the year then ended; and
- the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 and applicable law.

Opinion on other matters

In our opinion, the other information published together with the audited financial statements in the Narrative Report, the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the audited financial statements.

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Matters on which we are required to report by exception

We are required to report to you if:

- in our opinion the Annual Governance Statement does not comply with the guidance included in 'Delivering Good Governance in Local Government: Framework (2016)' published by CIPFA and SOLACE; or
- we have reported a matter in the public interest under section 24 of the Act in the course of, or at the conclusion of the audit; or
- we have made a written recommendation to the Authority under section 24 of the Act in the course of, or at the conclusion of the audit; or
- we have exercised any other special powers of the auditor under the Act.

We have nothing to report in respect of the above matters

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

Respective responsibilities of the Authority and auditor

The Authority is responsible for putting in place proper arrangements for securing 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 20(1)(c) of the Act to be satisfied that the Authority has made 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 the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria issued by the Comptroller and Auditor General in November 2016, as to whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

The Comptroller and Auditor General determined this criteria as that 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 2017.
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 has put in place proper arrangements for securing 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 issued by the Comptroller and Auditor General in November 2016, we are satisfied that in all significant respects the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate for the Authority for the year ended 31 March 2016 in accordance with the requirements of the Act and the Code until we have:
completed the work necessary to issue our Whole of Government Accounts (WGA) Component Assurance statement for the Authority for the year ended 31 March 2016, and
completed our consideration of other matters brought to our attention by the Authority.

We are satisfied that these matters do not have a material effect on the financial statements or on our conclusion on the Authority's arrangements for securing value for money through economic, efficient and effective use of its resources.

[Signature]

Phil Jones
for and on behalf of Grant Thornton UK LLP, Appointed Auditor

Colmore Building
20 Colmore Circus
Birmingham
B4 6AT

[Date]

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