Herefordshire Council

SUPPLEMENT TO THE AGENDA FOR

Audit and Governance Committee

Thursday 22 September 2016

2.00 pm

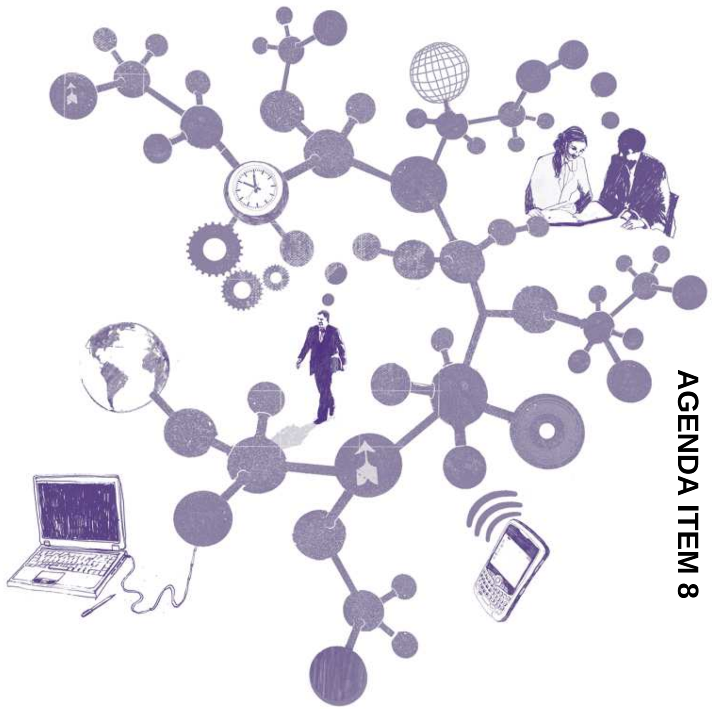
Committee Room 1, Shire Hall, St. Peter's Square, Hereford, HR1 2HX

		Pages
8.	**EXTERNAL AUDIT FINDINGS REPORT 2015/16** To update the committee on the external audit findings for 2015/16 – to include updated audit findings report including reference to the status of the audit opinion.	3 - 44

The Audit Findings for Herefordshire Council

Year ended 31 March 2016

22 September 2016



AGENDA ITEM 8

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22 September 2016

Dear Members of the Audit and Governance Committee,

Audit Findings for Herefordshire Council for the year ending 31 March 2016

This Audit Findings report highlights the key findings arising from the audit for the benefit of those charged with governance (in the case of Herefordshire Council, the Audit and Governance Committee), 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 auditors we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland), 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 sincerely

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 2016. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing (UK & Ireland) 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, whether it is consistent with the financial statements and in line with required guidance.

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 relevant period.

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

In the conduct of our audit we have had to alter our audit approach, which we communicated to you in our Audit Plan dated 23 March 2016. This was to incorporate an additional risk in relation to the value of the net pension fund liability due to this representing a significant estimate. This was not a reflection of local risks that came to light in Herefordshire but rather a national view that pensions constitute a significant risk within Local Government.

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

- obtaining and reviewing the management letter of representation
- updating our post balance sheet events review, to the date of signing the opinion
- Completion of our review of the initial discovery testing in respect of the Housing Benefit audit to inform our financial statements audit opinion
- Whole of Government Accounts

We received draft financial statements and accompanying working papers at the commencement of our work, in accordance with the agreed timetable.

Key audit and financial reporting issues

Financial statements opinion

We have identified no adjustments 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 2016 recorded net expenditure of £168.7m. We have recommended a number of adjustments to improve the presentation of the financial statements, however there has been no change to the out-turn net expenditure.

The key messages arising from our audit of the Council's financial statements are:

- The adoption of IFRS 13 in 2015/16 and the associated requirements were not adequately reflected in the accounts resulting in disclosure amendments in a number of areas.
- In certain areas the time taken to respond to queries posed by the audit team was too long. However we acknowledge that this has improved on the previous year. This will become even more important going forward in light of early closedown
- A small number of other disclosure findings were noted during the course of the audit

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

We anticipate providing 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 does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the information of which we are aware from our audit.

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 significant 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.

Health and Social Care Integration

The Council is currently operating in a challenged health and social care local economy. The Council's main partners in his area continue to report signifcant risk around their financial position. Pooled budget arrangements have been in place for a number of years but this year the CCG and Council established arrangements around the better care fund. We concluded that the Council has adequate arrangements around the financial operation of these pooled arrangement.

The Sustainabilty and Transformation Plan (STP) is being devloped as part of the DOH five year forward view, with an update expected in September. This plan is across Herefordshire and Worcestershire and builds on the Health and Social Care Transformation programme 'One Herefordshire'. The County has struggled to achieve significant 'transformation' to date to address the underlying financial and operational challenges.

Waste Incinerator PFI scheme

The annual accounts reflect further planned commitments to the PFI scheme. We reviewed the financial arrangements and concluded that these were appropriate.

Ofsted inspection of children's services

Ofsted issued a report on the Council's children's services in 2012/13 which rated these as 'inadequate' and the Council was reassessed as requires improvement during 2014/15. A stated Council ambition was that services would be rated 'good' during 2016/17. There are financial pressures around the service with chidrens' services directorate overspending against budget year on year.
Whilst there are on-going financial and operational risks around children's services and 'looked after' children we are satisfied that the Council is taking steps to respond to these risks.

Local Enterprise Partnership

As part of our review of risks, we considered the arrangements the Council has in place around partnership arrangements, specifically those around the Marches Local Enterprise Partnership. We found that whilst there are clearly set out and approved governance and accountability arrangements, in practice these are still evolving. The Joint Enterprise Committee is the principle means for Herefordshire Council to have assurance around financial governance of the LEP. We note that the Board has met relatively infrequently and little of a financial nature has been reported to it. The LEP has issued its first Annual Report this year. which is a positive step. However as Herefordshire Council's financial commitments have not been significant to date, we do not consider this to be a significant matter this year. Whilst it is not a code requirements, disclosure in a specific note to Herefordshire Council's accounts may provide greater transparency to interested parties on this partnership.

Capital monitoring

We reviewed the arrangements that the Council has in place around capital budget monitoring. There have been some well-documented errors in financial reports, however we do not consider that these indicate a weakness in the underlying monitoring arrangements. There is scope to improve both the quality control of committee reports and to improve transparency in reporting around individual schemes.

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 2016, 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 early October.

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 2016. We will report the outcome of this certification work through a separate report to the Audit Committee which is due in January 2017.

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 Acting S151 Officer.

We have made a number of recommendations, which are set out in the action plan at Appendix A. Recommendations have been discussed and agreed with the Acting S151 Officer and the finance team.

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 2016

Section 2: Audit findings

Materiality

In performing our audit, we apply the concept of materiality, following the requirements of International Standard on Auditing (UK & Ireland) (ISA) 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 £6,147k (being 1.8% of gross revenue expenditure in 2014/15). We have considered whether this benchmark remains appropriate during the course of the audit and have only revised our overall materiality to reflect the 2015/16 draft financial statements figures at £6,637k (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 £332k based on 2015/16 draft financial statements figures.

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
Cash and cash equivalents	Although the balance of cash and cash equivalents is immaterial, all transactions made by the Council affect the balance and it is therefore considered to be material by nature.	This is treated as a sensitive item and therefore no specific materiality value is set
Disclosures of officers' remuneration, salary bandings and exit packages in notes to the statements	Due to public interest in these disclosures and the statutory requirement for them to be made.	£25,000
Disclosure of auditors' remuneration in notes to the statements	Due to public interest in these disclosures and the statutory requirement for them to be made.	£25,000

Audit findings against significant risks

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

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

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
1.	**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. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	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
2.	**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.	We have performed the following procedures: • Review of the control environment in regards to the journal entry process • Testing of journal entries that are considered to be large or unusual • 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 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

Audit findings against significant risks continued

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
3.	**Accounting for the Better Care Fund** The 2015/16 financial statements included a new material pooled budget under a s75 agreement. The accounting treatment of this arrangement was complex in line with accounting standards in relation to Joint Arrangements (IFRS11)	We have performed the following procedures: • Obtained and reviewed the s75 agreement in place between the Council and Herefordshire CCG • We have established the Council's control environment in relation to the Better Care Fund and performed walkthroughs of key controls to ensure they are operating effectively • We have reviewed the reasonableness of the judgements made by the participants in assessing the control over the funds, and hence the accounting treatment • We have agreed BCF transactions, balances and disclosures in the accounts to the appropriate underlying evidence	Our audit work has not identified any issues in respect of the Better Care Fund and subsequent accounting treatment

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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	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 • Performed detailed substantive testing of a sample of employees for accuracy of payment and other assertions • Trend analysis of monthly payroll costs to identify any significant or unusual variances • Reconciliation of the payroll module to the general ledger to ensure completeness of information	Our audit work has not identified any significant issues in relation to the risk identified
Operating expenses	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 • Reconciliation of the creditors purchase ledger to the general ledger • Testing to identify potential unrecorded liabilities at period end • Testing of a sample of goods received not invoiced to identify items which have not been accrued correctly • Documentation of the process in place to accrue for liabilities at month and period end • Substantive testing of creditors balances at 31 March 2016 and a sample of operating expenditure transactions in the period	Our audit work has not identified any significant issues in relation to the risk identified

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.	**Valuation of pension fund net liability** The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.	We have performed the following procedures: • Documentation of the key controls that were put in place by management to ensure that the pension fund liability was not materially misstated • Walkthrough of the key controls to assess whether they were implemented as expected and mitigate the risk of material misstatement in the financial statements • 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 asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary Our audit work has not identified any issues in respect of the valuation of the pension fund liability.

Significant matters discussed with management

	Significant matter	Commentary
1.	The adoption of the accounting standard IFRS 13 (Fair Value Measurement) by the CIPFA Code of practice in 2015/16	The standard, which has been applied prospectively from 2015/16, provides a new definition and brings together fair value guidance into one standard that is applicable to almost all fair value estimates. We found that the financial statements were not in compliance with the enhanced disclosure requirements arising from the new standard in any respect The Council have subsequently revised the accounting disclosures and restated the correct fair value valuation of those liabilities stated above **Management response** During the audit increased clarity on generally accepted requirements were shared, agreed and reflected in the accounts.

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	• The accounting policies are appropriate under relevant accounting framework i.e. CIPFA Code of Practice • The accounting policy for revenue recognition has been adequately disclosed in the notes to the accounts • The accounting policies adopted are consistent when benchmarked against other similar Local Government bodies	●
Judgements and estimates	• Key estimates and judgements include: – Useful life of PPE – Revaluations – Impairments – Group Accounts – Valuation of pension fund net liability – Provision for NNDR appeals – Other provisions	• Accounting policies in relation to key estimates and judgements are appropriate under relevant accounting framework • Depreciation of fixed assets based on the useful economic life has been applied consistently between periods and is broadly in line with industry average • Significant impairments have been charged to the CIES in 2015/16 under the new de-minimus policy. This is considered reasonable • The basis on the which the Council conclude that group accounts do not need to be prepared (materiality) is in line with IFRS 11 • See comments on page 13 in relation to the valuation of the pension fund liability • Provisions included in the balance sheet as at 31 march 2016 have been calculated on a reasonable basis in line with statutory requirements where applicable	●

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

Accounting policies, estimates and judgements continued

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Accounting area	Summary of policy	Comments	Assessment
Going concern	The Acting 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 2015/16 financial statements.	●
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.	●

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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 and Governance Committee. We have not been made aware of any incidents in the period and no 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 identified one related party which was not disclosed. This was the South West Audit Partnership. The accounts have been updated for this accordingly
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
5.	**Confirmation requests from third parties**	• We requested from management permission to send confirmation request(s) to NatWest, the main banking provider of the Council, other financial institutions with whom an investment deposit is held and various lenders. This permission was granted and the requests were sent. We have received responses to all the request issued
6.	**Disclosures**	• Our review found disclosure omissions in the financial statements with regards to IFRS 13 (Fair Value Measurement). See 'Significant matters discussed with management' for further information

Other communication requirements continued

	Issue	Commentary
7.	**Matters on which we report by exception**	• We are required to report on a number of matters by exception in a number of areas: We have not identified any issues we would be required to report by exception in the following areas • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the information of which we are aware from our audit • The information in the Narrative Report is materially inconsistent with the information in the audited financial statements or our knowledge of the Group/Council acquired in the course of performing our audit, or otherwise misleading.
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. As the Council exceeds the specified group reporting threshold of £350m we are required to 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 and the planned timescale for the review is by the October 2016 deadline.

Internal controls

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

Our audit included consideration of internal controls 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. We considered and walked through the internal controls for Employee Remuneration and Operating Expenses as set out on page 13 above.

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

Unadjusted misstatements

There are no unadjusted misstatements

Misclassifications and disclosure changes

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

	Adjustment type	Value	Account balance	Impact on the financial statements
1	Misclassification	£135k	Grant Income	An amount of £135,000 for 'Supporting People', included in ' Credited to Services' had been incorrectly classified as a government grant as opposed to 'other contributions'
2	Disclosure	£24.4m	Long Term Debtors	Long term debtors have increased from £8.9m to £27m in 2015/16. Included in this total, is an amount of £24.4m 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 16 (financial instruments), and there is some reference to the loan arrangement under PFI disclosures, given the material value of a single transaction within the balance, we proposed that the Council include a separate disclosure note specifically for this item.
3	Disclosure	Various	Accounting Policies Investment Properties Financial Instruments	As stated above, the Council were required to revise disclosures in line with IFRS 13 for the following areas: - Accounting policies on fair value measurement - Investment properties to include the input level of the fair value hierarchy valuation of assets fall within - Financial instruments to include the input level of the fair value hierarchy valuation of liabilities fall within - Property, plan and equipment to replace references to fair value where this was no longer correct and replace with current value.
4	Disclosure	Various	Financial Instruments	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.

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Misclassifications and disclosure changes

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

	Adjustment type	Value	Account balance	Impact on the financial statements
5	Disclosure	£39.5m	Financial Instruments	The Council initially opted to not disclose the fair value of PFI liabilities on the grounds that the concession arrangement will not be terminated early and therefore carrying amount was a reasonable proxy for fair value. CIPFA Code paragraph 7.4.1.11 requires disclosure of fair value at each reporting date regardless of the fact these liabilities are held at amortised cost. Therefore we proposed an adjustment to amend the table with the fair value calculated of £39.4m
6	Disclosure	£2.2m	Financial Instruments	The Authority incorrectly excluded an accrual for £2.2m relating to holiday pay from the financial instruments disclosure, as a valid instrument (contractual obligation to pay cash) this was amended accordingly.
7	Disclosure	Various	Employee Remuneration	Disclosure note 30 (Officers Remuneration) and 31 (Termination Benefits) were revised from the draft accounts to agree to internal working papers and information
8	Disclosure	£200k	Related Parties	The disclosure of related party transactions has been revised to include the South West Audit Partnership.
9	Disclosure	N/A	Various	We have proposed various minor changes to the format and disclosure of the financial statements in order to improve presentation.

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.

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In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in November 2015. AGN 03 identifies one single criterion for auditors to evaluate:

> *In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed 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 out an initial risk assessment in January to February 2016 and identified the following significant risks, which we communicated to you in our Audit Plan dated March 2016.

- Health and social care integration
- Ofsted inspection of children's services
- PFI scheme – waste incinerator

We identified risks in respect of specific areas of proper arrangements using the guidance contained in AGN03.

Our risk assessment is a dynamic process and we have had regard to new information which emerged since we issued our Audit Plan:

In response to questions from members we also considered the following additional matters which we judged fell under the specified VFM code criteria:

- Reporting of the capital programme (sub criteria 'informed decision making')
- Financial reporting of LEP (sub criteria 'working with partners')

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:** how the council is managing the complex partnership arrangements around integrating care
- **Ofsted inspection of children's services**: progress the council is making against its improvement plan following the 2014 inspection
- **PFI scheme** – waste incinerator: progress with project and how the financial implications are being factored into financial plans

Other considerations:

- **LEP project:** financial reporting and governance of HUA commitments to the LEP
- **Capital reporting**: accuracy and effectiveness of capital programme reporting to members.

We have set out more detail on the risks we identified, the results of the work we performed and the conclusions we drew from this work later in this section.

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 working in a challenged health and social care economy. The Council is seeking to deliver wide ranging changes and greater integration to ensure the financial sustainability of adult health and social care services through its transformation agenda and through working with partners in health.	We will review the project management and risk assurance frameworks established by the Council to establish how it is identifying, managing and monitoring these risks.	The Council is operating in a particularly challenged health and social care economy. There are considerable financial challenges particularly at Wye Valley Trust, but also increasingly at Herefordshire CCG and at the Council. Historically, there has not been sufficiently effective working between partners in Herefordshire to drive the necessary transformational change in the system. A draft Sustainability and Transformation Plan has been prepared which covers both Herefordshire and Worcestershire and a revised draft is expected to be submitted to NHS England in October. At the time of our review there was still a financial gap across the STP but it is hoped that this will be addressed in the October submission. Within Herefordshire, beneath the STP, sits the 'One Herefordshire' initiative. To manage the 'system transformation', work is being taken forward to establish an alliance between the NHS providers and to extend joint commissioning arrangements between the council and the CCG. It is hoped that the STP plan and new leadership will give much needed impetus to transformational change. The introduction of the better care fund and incentive to pool budgets with partners in the health sector is a complex arrangement and requires robust governance and project management to ensure delivery and VFM is being delivered. We are satisfied from the evidence gathered that the Council has established arrangements effectively around the integration with health services which will provide the appropriate oversight. This is due to the extensive board structure in place taking into consideration representatives of both parties to the s75 agreement, as well as NHS providers that are not party to the agreement, and thus encompassing fully the concept of collaboration. In addition to this, a comprehensive risk sharing agreement has been produced which is underpinned by the specific risk register. It is expected that this risk sharing agreement will be developed year on year. On review of said documents, the risks appear reasonable and appropriate in nature and therefore demonstrate the Council has considered the possible implications of the integration. The Council and its partners will however need to act on these plans to ensure that the STP delivers positive health outcomes for local people and to build long-term financial resilience.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Health & Social Care Integration (cont.) The Council is working in a challenged health and social care economy. The Council is seeking to deliver wide ranging changes and greater integration to ensure the financial sustainability of adult health and social care services through its transformation agenda and through working with partners in health.		Finally, the reporting process is thorough and frequent enough to keep up to date with emerging issues in a timely manner. The breadth of involvement is conducive to informed decision making by the relevant party and as such we consider that appropriate arrangements are being put in place to mitigate the risk, whilst recognising the overarching inherent financial risks within the system. **On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements**
PFI scheme – waste incinerator The council is a party to a significant PFI contract for a waste incinerator. This is a significant financial commitment and has been a high profile matter. This links with arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and to maintain statutory functions.	We will obtain an understanding of where the council are in this project and how the financial implications are being managed and factored into financial plans.	We are satisfied that the Council has adequate arrangements in place to secure value for money in the delivery of the waste incinerator PFI agreement. This is supported by the stable financial position of the partnership, a forecast surplus for the Council and timely management of relationship and dispute issues resulting in limited financial impact. It is evident from our review of documents and through discussions with client personnel that the scheme has been factored in to the long term financial projections of the Council with loan repayments spread up to 2042 or the useful economic life of the plant. The borrowing necessary has also been undertaken in line with the relevant prudential strategy and in a responsible manner. The majority of debt is sourced from PWLB at rates favourable to the council and thus resulting in a surplus on repayment. We have gained assurance that governance procedures are being implemented to a satisfactory level which has included the audit committee discussing the scheme regularly and providing appropriate oversight at their meetings. Finally, the financial and operational aspects of the scheme have also been reported on positively by external third parties, specialising in their respective areas. As such, we do not consider the waste incinerator PFI scheme to pose a threat to our value for money conclusion, no further work is proposed on this matter. **On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements**

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Ofsted inspection of children's services Ofsted issued a report on the Council's children's services in 2012/13 which rated these as 'inadequate'. A re-inspection in 2014/15 took the council to a 'requires improvement' assessment. Until such time as Ofsted has confirmed that adequate arrangements are in place this remains a significant risk to the Council's arrangements.	We reviewed the improvement plan, risk register , financial reports and met with the Children's services financial lead. No follow up inspection has taken place.	The Council has responded to the Ofsted inspections. There has been some change in senior staff which is providing challenge to some of the existing culture and arrangements. Following the inspection there has been a detailed improvement plan developed and we have seen evidence that this is monitored and updated regularly. There has been no follow up Ofsted inspection to assess whether the actions are addressing the underlying problems. Many of the weaknesses are being addressed by further reviews, not all of which have been completed. It would therefore be premature to conclude that the Council will achieve its stated ambition of being 'good' during 2016/17. The Children's Services Directorate continues to overspend as reflected in a £2m overspend on the £24m budget in 2015/16 Quarter 1 financial information was not available at the time of our review, although it is anticipated that this will continue to show budget challenges although the council is taking steps to reduce risks. Discussion with responsible finance officers indicates new measures are being taken this year, for example a fundamental change to the use of agency staff which should have recurring positive financial impact. Any new initiatives will take time to impact on the underlying financial position. **Whilst there are on-going financial and operational risks around children's services and 'looked after' children we are satisfied that the Council is responding appropriately to these risks. On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements**

Key findings (continued)

New risk	Work to address	Findings and conclusions
Governance arrangements, from Herefordshire Council perspective around the Local Enterprise Partnership	We will review the governance arrangements around the LEP to assess whether or not these are adequate and whether adequate information is supplied to those Charged with Governance (TCWG) to fulfil their responsibilities.	In 2015/16 the LEP received around £16m of income. Transactions that related to Herefordshire Council were not material but are expected to increase in future periods. Accounting arrangements for the LEP are proper and reflect the fact that the LEP is not an entity. Shropshire Council is the accountable body fro the LEP so all external funding etc. is reflected in its financial ledger. The accounting arrangements ordain that Shropshire Council acts as an agent and thus any LEP income and expenditure which relates to Herefordshire Council is reflected in Herefordshire Council's accounts and audited as part of the audit of its accounts. There are no specific notes on the LEP within Herefordshire Council's accounts and due to the value of transactions, this is not required in 2015/16. For transparency purposes, public interest, and in view of the expected increases in projects the Council may wish to consider including a specific note in future statements of accounts. The LEP has produced an annual report in 2015/16 which is important in view of the increasing amount of projects and funding going through the organisation. As the LEP is not an entity it is not required to produce any year end financial reports, though the annual report does contain some financial context. Shropshire Council's statutory accounts now do include a note (note 37) which sets out all the LEP related transactions. The LEP does have an agreed accountability framework which sets out the decision making and governances responsibilities of the Board, joint committee etc. Governance arrangements in practice have been evolving over the last 2 years. It is the responsibility of the joint committee for 'ensuring accountability of budget making and policy decision'. However the committee has not met frequently (the committee website indicates that numerous committees have been cancelled and postponed) and we have seen little financial information being reported to it. In March 2016 the NAO issued a report which highlighted a lack of accountability in relation to LEPs as a national issue. Whilst Shropshire Council is the accountable body, as described above relevant income and expenditure is reflected in Herefordshire Council accounts - and thus Herefordshire council is ultimately accountable for those transactions. It is therefore important that TCWG at Herefordshire Council are appropriately engaged with, and sighted on, the activity of the joint committee - as this is the main vehicle of assurance over LEP governance. **Appropriate accountability and reporting arrangements are in place in relation to the LEP. On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements**

Key findings (continued)

New risk	Work to address	Findings and conclusions
Adequacy of the Council capital reporting	We have reviewed reports to council in relation to the 2015/16 capital programme.	The capital budget for 2015/16 as presented in the revised 2015 MTFS differs to that presented in the 2016 MTFS, both in total and by a number of individual schemes. The revised presentation of the restated 2015/16 capital outturn report makes it difficult to track through what was originally approved in the 2015 MTFS (£67,929 restated total budget) to the 2016 MTFS 2015/16 budget and also to the reported out-turn (both £77,089 budget) by individual project. Over the period of review, it is highly probable that in any organisations there may be revisions to budgets, reclassifications and virements. Development of reports and altering of presentations are also usual. The variations described above may well have been explained at committees. However looking back over the reports, it is understandable that there may be difficulties by users of financial reports tracking through budgets on all individual schemes. The Council has also itself highlighted a number of errors in its reports over the period. The June outturn report was reissued. There are clearly lessons to be learned around quality control of financial reporting to committee. It appears to us that these are errors, omissions and oversights rather then there being a deliberate intention to mislead. The errors and omissions are unfortunate but are not so material as to indicate that there are fundamental weaknesses in the Council's reporting of its capital programme. **We concluded that the risk was sufficiently mitigated and the Council has proper arrangements**

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Significant difficulties in undertaking our work

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Any other matters

There were no other matters from our work which were significant to our consideration of your arrangements to secure value for money in your use of resources.

Section 5: Fees, non-audit services and independence

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

Fees

	£
Council audit	124,405
Housing benefits certification (tbc)	4,571
Total audit fees (excluding VAT)	**128,978**

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'.

Fees for other services

Service	Fees £
Audit related services:	
• Teachers Pensions Return (tbc)	4,200
• SFA grant certification (tbc)	3,000

Independence and ethics

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

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

Section 6: Communication of audit matters

Communication to those charged with governance

International Standards on Auditing 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.

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

Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by 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		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

Appendices

Appendix A: Action plan

Priority
High - Significant impact
Medium – Moderate impact
Low - Best practice

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
1	To continue the positive work undertaken in respect of fixed assets in 2015/16, taking in to account significant developments on highways network assets which will be recognised separately under DRC in 2016/17. We plan to liaise with officers early in the process to ensure the treatment of these assets is appropriate in line with the revised HNA Code when this is released.	High	The corporate finance team has an action plan in place to ensure that the highway network assets are correctly valued and disclosed in 2016/17s statement of accounts. We will work with Grant Thornton throughout this process.	April 2017 Corporate Finance Manager to lead
2	To ensure that prior to the completion of the draft financial statements subject to audit, the Authority have reviewed any notable changes to the Code of Practice or CIPFA LAAP bulletins. This will mitigate any risk of non-compliance with the disclosure requirements of the Code in major areas such as IFRS 13 in 2015/16.	Medium	Agreed, training updates are to be shared as they become available.	March 2017 Head of Corporate Finance
3	Robust quality control measures put in place around financial reporting to members, particularly around the capital programme. We will discuss with officers good practice reporting.	Medium	Agreed, data quality checks are already in place, going forward improved clarity and transparency will be adopted using evidenced best practices.	February 2017 Head of Corporate Finance

Appendix A: Action plan

Priority
High - Significant impact
Medium – Moderate impact
Low - Best practice

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
4	Consider including a note on the LEP including the transactions with the LEP within a note to the 2016/17 statement of accounts.	medium	Agreed	May 2017 Head of Corporate Finance

Appendix B: Audit opinion

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEREEFORDSHIRE COUNCIL

We have audited the financial statements of Herefordshire Council (the "Authority") for the year ended 31 March 2016 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 2015/16.

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 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 S 151 and auditor

As explained more fully in the Statement of Responsibilities, the S151 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 2015/16, 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 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 s151 Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Narrative Report and 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 2016 and of its expenditure and income for the year then ended; and
have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 and applicable law.

Opinion on other matters

In our opinion, the other information published together with the audited financial statements in the Narrative Report and the Annual Governance Statement is consistent with the audited financial statements.

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: a Framework' published by CIPFA/SOLACE in June 2007; or
we issue a report in the public interest under section 24 of the Act; or
we make a written recommendation to the Authority under section 24 of the Act; or
we exercise any other special powers of the auditor under the Act.

We have nothing to report in these respects.

Conclusion on the Authority's arrangements to secure value for money through economic, efficient and effective use of its resources

Respective responsibilities of the Authority and auditor

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

We are required under Section 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.

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Scope of the review of the Authority's arrangements to secure value for money through economic, efficient and effective use of its resources

We have undertaken our review in accordance with the Code of Audit Practice prepared by the Comptroller and Auditor General as required by the Act (the "Code"), having regard to the guidance on the specified criteria issued by the Comptroller and Auditor General in November 2015, 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 these criteria as those necessary for us to consider under the Code in satisfying ourselves whether the Authority put in place proper arrangements to secure value for money through the economic, efficient and effective use of its resources for the year ended 31 March 2016.

We planned our work in accordance with the Code. 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 to secure value for money through economic, efficient and effective use of its 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 2015, we are satisfied that in all significant respects *the Authority* has put in place proper arrangements to secure value for money through economic, efficient and effective use of its resources for the year ended 31 March 2016.

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.

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

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26 September 2016

Grant Thornton

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