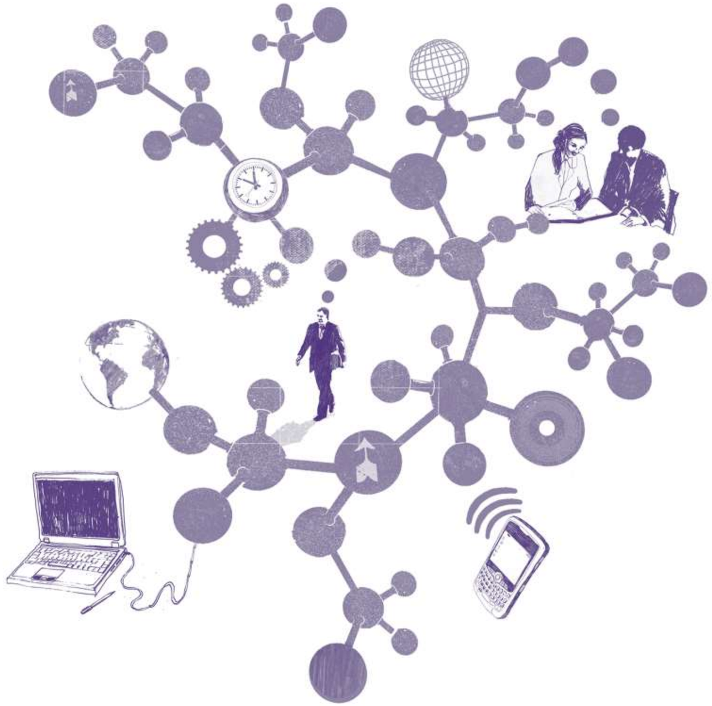
The Annual Audit Letter for Herefordshire Council

Year ended 31 March 2017

October 2017



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Contents

Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work we have carried out at Herefordshire Council (the Council) for the year ended 31 March 2017.

This Letter provides a commentary on the results of our work to the Council and its external stakeholders, and highlights issues we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit and Governance Committee (as those charged with governance) in our Audit Findings Report on 20 September. A further update was provided on 28 September which we understand was circulated to members of the Committee.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 29 September 2017.
As we reported in our Audit Findings Report, there were weaknesses in the quality and accuracy of the accounts presented but also in how the audit was supported by the Council. Material changes were made to the accounts.
If our experience is repeated in 2017/18 it is clear that we will be unable to achieve the new 31 July deadline for issuing the opinion on the accounts.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2017. We reflected this in our audit opinion on 29 September 2017 2017.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of Herefordshire Council as we have not yet completed our consideration of other matters brought to our attention by the Council.

Certification of grants

We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2017. We will report the results of this work to the Audit and Governance Committee in our Annual Certification Letter.

Working with the Council/Authority

This report summarises the matters raised in our audit findings report. There are a number of areas highlighted that require attention in 2017/18 to improve arrangements and to enable the accounts to be published by July 2018. We will consider the progress the Council is making as part of our ongoing liaison with officers and as part of our planning for 2017/18, early in the new year.
We are already discussing with officers the timetable for our work in 2017/18.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
October 2017

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we applied the concept of materiality to determine the nature, timing and extent of our work, and to evaluate the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £5.9 million, which is 1.8% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for related parties and senior officer remuneration.

We set a lower threshold of £295,000, above which we reported errors to the Audit and Governance Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by the Chief Finance Officer are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts included in the Statement of Accounts on which we gave our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

The following pages summarise our work and our findings against the risks we reported to you in our Audit plan in March 2017.

Audit of the accounts – Herefordshire Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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 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. This matter was finally resolved to our satisfaction in September. **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 were sought. Material errors and subsequent adjustments were made to the accounts 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 we were informed that completion would be 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. We have recommended that this classification is properly considered in 2017/18 and supported by the view of an appropriately qualified valuer. 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 a critical judgment, the basis of which should be explained, but has now been included in the accounts. The revised accounts reflect a non adjusting post balance sheet event' disclosure to reflect the position when the accounts were approved. This is likely to be a material matter in the 2017/18 accounts. We expect that officers will keep us appropriately informed of developments and that any disposals and the valuation of all these assets will be in line with code requirements, be fully supported by current valuation and will be clearly referenced to in the accounts

Audit of the accounts

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the pension fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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 was made in the draft accounts. We had been discussing this matter since the interim audit and were assured that evidence would be made available to support the inclusion in the accounts. The Council sought advice on this matter and the accounts were adjusted in September 2017. We are satisfied that the IAS 19 disclosures have been appropriately adjusted and are not materially misstated. We also discussed with officers the council's commitment to the pension fund for pre 2011 Hoople Ltd liabilities and how this should be recognised in the accounts. Officers explained their judgement as to why this was not an insurance contract or a derivative financial liability. We concluded that the matter was not material.

Audit of the accounts

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the pension fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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.	The accounts presented were not compliant with the new Code requirements and a number of audit adjustments were 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 was not achieved in the first draft of the accounts. . Adjustments were made as follows: 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 2015/16. 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. 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 of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 29 September 2017, in advance of the 30 September 2017 national deadline.

The Council made the accounts available for audit in line with the agreed timetable and the audit was completed and signed off by the statutory deadline. However, as reported in the audit findings report, the audit was protracted. In particular, we had problems completing our wok on Property Plant and Equipment (PPE), pensions, the Energy from waste PFI and our review of the presentation of the accounts against the revisions to the code. Material adjustments were made to the accounts in some of these areas. In the Audit Findings Report (AFR) we reported that the accounts themselves were not of a high quality, the finance team was not sufficiently prepared and the audit was not generally well supported. Please see the AFR for further detail.

The Audit and Governance Committee delegated approval of the accounts to the S151 Officer because there were several unresolved matters when the accounts and the draft Audit Findings Report was presented on the 20th September 2017. Further adjustments were then made to the accounts and a final Audit Findings Report was issued and circulated to members, prior to the accounts being authorised, and the opinion issued, on the 29 September 2017.

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It is mandated that there is an accelerated timetable for closedown in 2017/18, with the deadline for approval of the accounts, and the opinion to be issued by 31 July 2018. We have already met and discussed with the Deputy S151 an outline timetable to meet this revised deadline. The Audit and Governance Committee should obtain assurance that appropriate arrangements are in place to prepare good quality accounts, which address the shortfalls in the 2016/17. Property Plant and equipment (PPE), and preparation of a high quality Narrative Foreword are areas where the Committee should seek specific assurance that improved arrangements are in place.

The Council is procuring a new external valuer to undertake work on PPE and there are also some staff changes in the finance department, so there is some continuing risk to the preparation of the accounts in 2017/18.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2016 which specified the 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.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out in table 2 overleaf.

Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2017.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	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 followed up progress on the 'One Herefordshire' plan.	**We 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 clearer priorities and expected outcomes of the STP / One Herefordshire process. It is early in the implementation of the STP, although work is progressing with work streams. Focus this year has been on strengthening governance arrangements. It is still too early to assess how effective arrangements are in practice. The Joint Commissioning Board (as part of the Better Care Fund Framework) and Health and Wellbeing Board consider specific areas. We do note that there is little representation by the providers in these forums. At the time of our review the partners had yet to finalise the Better Care Fund targets and budgets for 2017/18. 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.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	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 gained an understanding of the financial settlement impact and the Council's response to it and what arrangement the Council had 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 shows that the Council achieved a moderate overall underspend against the revised budget for 2016/17. This budget incorporates planned savings of around £10m. 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. Current forecasts indicate that current savings plans are not being achieved in two service directorates leading to forecast overspends in these areas. The Finance team anticipate that much of this will be offset by savings within the Communities Directorate. 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 through in- year monitoring These arrangements are appropriate. Inevitably there is some virement of budgets between services and directorates during the year, and savings are embedded within budgets. Transparency would be improved through reporting of year end savings in out-turn reports at a scheme level and more detail being provided within the Narrative Foreword of the financial statements.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
Production of the financial statements We have considered whether the weakness in arrangements in the production of the 2016/17 financial statements are matters for our value for money conclusion (under the informed decision making criteria)	We have considered the 2016/17 audit of accounts and the concerns we have raised within the Audit Findings Report and whether the reported weaknesses are a matter for our value for money conclusion.	**We have concluded that the weakness in the accounts process this year is not a matter for the value for money conclusion.** We hope to see management put processes in place to ensure that the weakness in many aspects of the 2016/17 accounts preparation are addressed by introducing clear plans for improvement for 2017/18. Particular improvement is required around the valuation of property plant and equipment. We hope to see greater importance given to the accounts so that they are accurate and informative and right first time. Enhancements should be made to both the Annual Governance Statement and the Narrative foreword to make them clearer and more informative, supporting the Council's stated commitment to improved governance and transparency. We will consider whether this area is a VfM conclusion risk for 2017/18 at interim, taking into account the Council's arrangements for planning for the 2017/18 closedown. As this year's experience is not consistent with the previous year's, our view is that the reported weaknesses would not adversely impact on our value for money conclusion.
Blue school house: The report to the September Audit and Governance Committee of failures around the Blue School House capital project. The failures indicate weakness across all three VFM areas: *Informed decision making*: acting in the public interest through demonstrating and applying the principles and values of sound governance: managing risks effectively and maintaining a sound system of internal control, *Working with partners and other third parties*: procuring supplies and services effectively to support the delivery of strategic priorities *Sustainable resource development:* planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions	We have considered the internal audit report and considered whether this presents a matter for our value for money conclusion.	**We have concluded that this is not a matter that will adversely impact on our value for money conclusion** The matters raised in the report are worrying and indicate weakness in governance, reporting and a failure to follow formal processes. The report does not however conclude that the failings in capital project procurement and management are widespread, as that was not within the scope of the review. We raised concerns in our 2015/16 VfM conclusion around the adequacy of capital reporting and the internal audit report indicates that these weakness have yet to be addressed adequately. Whilst there are clear and accepted failings in this scheme, the project and the overspend were not in themselves sufficiently material to lead to a qualification of the VfM conclusion. The Council has responded appropriately by both considering the report in a public meeting and establishing a board to oversee improvements. We considered that the matters should be clearly referenced in the revised Annual Governance Statement and are not a matter for the VFM conclusion.

Appendix A: Reports issued and fees

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

Fees

	Proposed fee £	Final fee £	2015/16 fees £
Council audit	124,405	TBC	124,405
Audit of subsidiary company: Hoople Limited (audit not yet complete)	14,780	TBC	14,000
Audit of subsidiary company/ joint committee west Mercia Energy £13,000 prorate to HUA	4,333	TBC	4,333
Grant certification: Housing Benefits indicative (audit not yet complete)	5,415	TBC	5,806
Total audit fees (excluding VAT)	**148,933**	**TBC**	**148,544**

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.

Reports issued

Report	Date issued
Audit Plan	March 2017
Audit Findings Report	September 2017
Annual Audit Letter	October 2017

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

Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all other services which were identified.
- We have considered whether other 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, as reported in our Audit Findings Report.

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
Non audit services	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.
Non audit services	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.