

The Annual Audit Letter for Shepway District Council

Year ended 31 March 2016

October 2016

Elizabeth Jackson
Engagement Lead
T 020 7728 3329
E elizabeth.l.jackson@uk.gt.com

Lisa Robertson
Engagement Manager
T 020 7728 3341
E lisa.e.robertson@uk.gt.com

Dale Connelly
Engagement In-charge
T 020 7383 5100
E dale.s.connolly@uk.gt.com



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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Shepway District Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that 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 21 September 2016.

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 23 September 2016.

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 2016. We reflected this in our audit opinion on 23 September 2016.

Use of additional powers and duties

We are required under the Act to give electors the opportunity to raise questions about the Council's accounts and we consider and decide upon objections received in relation to the accounts.

During the course of our audit we have been contacted by local electors who have raised objections to the 2015/16 financial statements under Section 27 of the Act. Our review of the objections is currently at the initial investigation stage.

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 our consideration of objections.

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.

On completion of our investigation, our findings will be reported to the Audit and Governance Committee.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of Shepway District Council as we have not yet completed work in respect of objections received.

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 2016. We will report the results of this work to the Audit and Governance Committee in our Annual Certification Letter.

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 2016

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating 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 £1,724,000, which is 2% 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.

As we reported in our audit plan, we did not identify any areas where we decided that a separate materiality level was appropriate.

We set a lower threshold of £86,000, 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 that 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 management 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 on which we give 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.

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.

Table 1: Opinion risks

Risks identified in our audit plan	How we responded to the risk
<p>The revenue cycle includes fraudulent transactions</p> <p>Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p> <p>The expenditure cycle also includes fraudulent transactions.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Shepway District Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • 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 Shepway District Council, mean that all forms of fraud are seen as unacceptable. <p>We have considered the expenditure cycle risk and do not consider it to require additional procedures. The lack of specific financial performance targets which Shepway District Council is requirement to meet means there is limited incentive for fraudulent manipulation. The culture within Shepway District Council means that such manipulation would be seen as unacceptable. The nature of expenditure streams also means that material expenditure recognition fraud would be difficult to perpetrate and conceal. Our normal substantive procedures, including the work done in relation to the risk of management override of controls, adequately address the risk of fraud through provisions and accruals.</p> <p>We did not identify any issues to report.</p>
<p>Management over-ride of controls</p> <p>Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • review of entity controls • testing of journal entries • review of accounting estimates, judgements and decisions made by management • review of unusual significant transactions <p>We did not identify any issues to report.</p>

Audit of the accounts – continued

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of property plant and equipment</p> <p>The Council's property, plant and equipment, including its housing stock, represents 76% of its total assets. Their value is estimated by property valuation experts.</p> <p>The Council revalues these assets on a rolling basis.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • Reviewed management's processes and assumptions for the calculation of the estimate. • Reviewed the competence, expertise and objectivity of any management experts used. • Reviewed the instructions issued to valuation experts and the scope of their work • Discussed with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions. • Reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding. • Tested revaluations made during the year to ensure they were input correctly into the Council's asset register • Evaluated how management satisfied themselves that these were not materially different to current value. • Reviewed disclosures made by the Council in its financial statements to ensure they are in accordance with requirements of CIPFA Code of Practice and IFRS13 <p>We did not identify any issues to report.</p>
<p>Valuation of pension fund net liability</p> <p>The Council's pension fund asset and liability, as reflected in its balance sheet, represents a significant estimate in the accounts and comprises 45% of its total liabilities.</p> <p>The values of the pension fund net liability is estimated by specialist actuaries.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • 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 • Reviewed the competence, expertise and objectivity of the actuary who carried out your pension fund valuation and the basis they used • Reviewed the consistency of the pension fund asset and liability and disclosures in the notes to the financial statements with the actuarial report from your actuary. <p>We did not identify any issues to report.</p>

Audit of the accounts – continued

Risks identified in our audit plan	How we responded to the risk
<p>Operating expenditure</p> <p>The Council reported £11,540,000 short term creditors as at 31 March 2016. Of this, 46 % were sundry creditors.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • Documented our understanding of processes and key controls over the transaction cycle • Undertook walkthroughs of the key controls to assess the whether those controls were in line with our documented understanding • Completed cut off testing to assess whether transactions are recorded in the correct period • Completed substantive testing of operating expenditure payments • Completed substantive testing of year end payable balances • Reviewed accruals <p>We did not identify any issues to report.</p>
<p>Employee Remuneration</p> <p>The Council's expenditure on employees, represents 16% of its total expenditure</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • Documented our understanding of processes and key controls over the transaction cycle • Undertook walkthroughs of the key controls to assess the whether those controls were in line with our documented understanding • Completed trend analysis and risk identification for monthly payroll costs • Completed substantive testing of payroll payments <p>We did not identify any issues to report.</p>

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 23 September 2016, in advance of the 30 September 2016 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit and Governance Committee on 21 September 2016.

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

- our testing did not identify any changes to the primary financial statements;
- our audit identified a small number of presentational and disclosure adjustments to the financial statements; and
- the statements were supported by well prepared working papers. However, we did identify that a summary paper mapping the financial statements to the trial balance would be helpful in future years.

Annual Governance Statement and Narrative Report

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council/Authority and with our knowledge of the Council/Authority.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

During the course of our audit we have been contacted by local electors who have raised objections to the 2015/16 financial statements under Section 27 of the Act. Our review of the objections is currently at the initial investigation stage. On completion of our investigation, our findings will be reported to the Audit and Governance Committee.

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 2015 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 2016.

Value for Money

Table 2: Value for money risks

Significant risk
<p>Medium term financial resilience</p> <p>In recent years the Council's Medium Term Financial Strategy (MTFS) has provided a sound framework to meet its financial challenges and the Council has been able to add to its usable reserves. This financial year the Council is on track to underspend on its General Fund. However, looking further ahead the latest version of the MTFS (published in October 2015) sets out a cumulative funding gap of around £5 million over the next five years. Since the publication of the latest version of its MTFS the Council, like most of the other Kent districts, has received a challenging settlement from the Department of Communities and Local Government. Initial work by the Council has shown that Revenue Support Grant will be £3.5m less than assumed in its current MTFS.</p> <p>Although a balanced budget for 2016/17 has been set the Council is facing significant financial challenges from 2017/18 onward. To help address these challenges the Council is moving forward with a series of business process engineering reviews and is focused on maximising its revenue earning opportunities. For example, the acquisition of land at Oterpool Manor Farm.</p>
Work to address
<p>We reviewed the Council's arrangements for updating and developing its medium term financial planning, including the actions proposed to address the medium term financial shortfall.</p>
Findings and conclusions
<p>2015/16 outturn</p> <p>The Council has returned a surplus of £61k for 2015/16, an improvement of £157k on the latest approved budget when a deficit of £96k was forecast. This outturn includes a transfer of £1.2m to earmarked reserves, representing a £2.5m improvement on the projected position which originally envisaged that £1.3m of reserves would be applied to meet spending pressures. Most of the transfer is in respect of underspent budgets carried forward into 2016/17.</p> <p>Other important factors affecting the improved position included a substantial increase in Business Rates Income (£1.182m), due mainly to a reduction in the levy rate by the Kent Business Rates Pool. With regard to Housing Benefits, the Council's focus on anti-fraud measures produced an increased recovery of overpaid Rent Allowances totalling £1.1m more than expected, although an increase in claimants led to additional £0.7m expenditure to offset this sum. This rise in claimants has prompted the Council to increase the bad debt provision by £0.5m more than budget.</p> <p>Elsewhere the Council delivered a number of underspends totalling £1.5m. These included savings identified as a result of the review of base budgets for the 2016/17 budgeting exercise, reductions in anticipated costs and rephasing work. Increases in income and additional grants were £1m above originally expected and including a grant of £0.4m towards the Junction 11 project and £0.3m from increases in parking and planning charges.</p>

Key findings

Findings and conclusions continued

2016/17 budget and Medium Term Financial Strategy (MTFS)

The Council approved a balanced budget for 2016/17. This was achieved after a 1.99% increase in Council Tax and a rigorous process to address a projected shortfall of £1.7m and a reduction in funding of £1.1m imposed by the financial settlement which was itself some £0.4m more than originally anticipated. The 2016/17 budget will be supported by transfers from reserves, currently projected to be £1.1m from the General Reserve and £4.4m from various earmarked reserves.

The underlying assumptions within the budget include 3% for pay awards and a similar sum for increased national insurance charges, which appear prudent. Contract inflation has been built in and interest receivable increased by £0.1m to £0.6m which will need to be monitored closely within the current financial climate. In addition very limited revenue growth of £81k is anticipated.

Savings and efficiencies totalling £1.2m originating from a base budget review in 2015 are a key element in closing the funding gap in 2016/17 and delivery of these savings will need to be monitored closely. Within the package of measures, £0.35m is dependent on implementing the transformation of Revenues and Benefits in the second half of 2016/17, £0.1m relates to Veolia contract cost reductions and £0.1m due to ICT contract savings. Although it covers only the first two months, the first monitoring report for 2016/17 activity is encouraging, reporting a slight underspend of £0.1m. The Council must continue to monitor budgetary performance closely and utilise the centrally managed contingency of £0.2m prudently.

The Council faces significant financial challenges beyond 2016/17. The anticipated reduction in revenue support grant has been modelled along with the financial implications of economic conditions, legislative changes (New Homes Bonus and Business Rate distribution) and potential additional responsibilities. As a preliminary to 2017/18 budget preparations the Council updated its Medium Term Financial Strategy (MTFS) in September 2016.

The MTFS projects that a balanced budget for 2017/18 will require applying a transfer of £1.8m from the General Reserve and the delivery of savings of £1.2m. A programme of savings proposals across services has been prepared taking recent budgetary performance and known legislative changes into account.

For years 2018/19 on to 2020/21 similar levels of savings will be insufficient to achieve balance, and shortfalls of £0.5m rising to £1.5m are currently projected. Furthermore, by 2017/18 the General Reserve is projected to be at its assessed minimum level and thus the opportunities to apply further contributions from the GR beyond 2017/18 are limited without further contributions being made to this Reserve.

In February the Council reported the various strategies to address the medium term funding gap, including the Digital Transformation Board, the regeneration and housing company Opportunitas, a range of projects and use of reserves. It is also taking forward plans to develop Otterpool Manor Farm which has income generating potential. As it prepares to enter the 2017/18 budget preparation process within a tighter financial regime and with minimal scope to utilise reserves, the Council is aware of the shortfalls it needs to cover from 2018/19 and is taking steps to identify further opportunities for savings and income generation to cover the gaps.

On the basis that the Council has demonstrated sound financial management in delivering a small surplus in 2015/16 and the capacity to address a significant shortfall of £1.7m by approving a balanced budget in 2016/17 we conclude that the risk is sufficiently mitigated and proper arrangements are in place. We have raised one recommendation which is in Appendix A of this report.

Working with the Council/Authority

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – we delivered the accounts audit seven days before the deadline and in line with the timescale we agreed with you. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work.

Improved financial processes – during the year we reviewed your financial systems and processes including employee remuneration, non- pay expenditure and property plant and equipment. We worked with you to streamline your processes and made recommendations to further streamline such as de-cluttering, working papers and local elector review.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness. We highlighted the need for the Council to continue to monitor budgetary performance closely. As it prepares to enter the 2017/18 budget preparation process within a tighter financial regime and with minimal scope to utilise reserves, the Council is aware of the shortfalls it needs to cover from 2018/19 and is taking steps to identify further opportunities for savings and income generation to cover the gaps.

Sharing our insight – we provided regular audit committee updates covering best practice. Areas we covered included: Knowing the Ropes – Audit Committee: Effectiveness Review; Making devolution work; Reforging local government; and Building a successful joint venture.

Providing training – we provided your teams with training on financial accounts and annual reporting. The courses were attended by your finance officers.

Providing information – we provided you with Health and Wellbeing data for the Shepway providing a socio-economy context, compared across the country.

We will also continue to work with you and support you over the next financial year.

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and confirm there were no fees for the provision of non audit services.

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Shepway District Council	60,458	60,458	80,610
Housing Benefit Grant Certification	11,166	*tbc	17,250
Total fees (excluding VAT)	71,624	Tbc	97,860

The proposed fees Council audit and Grant Certification fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

* 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'. This work is due to be completed by 30 November deadline and we will confirm the final fee in our Grant Certification report to Committee in December 2016.

Fees for other services

Service	Fees £
Audit related services:	
• Certification of housing pooling capital receipts return	2,000

Reports issued

Report	Date issued
Audit Plan	May 2016
Audit Findings Report	September 2016
Annual Audit Letter	October 2016



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