

Borough Council of King's Lynn and West Norfolk

Audit and Risk Committee Summary

For the year ended 31 March 2015

Audit Results Report – ISA (UK and Ireland) 260

September 2015



Building a better
working world

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Section 1

Executive summary

Executive summary – key findings

Audit results and other key matters

The Audit Commission's Code of Audit Practice (the Code) requires us to report to those charged with governance – the Audit and Risk Committee – on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified. This report summarises the findings from the 2014/2015 audit which is substantially complete. It includes the messages arising from our audit of your financial statements and the results of the work we have undertaken to assess your arrangements to secure value for money in your use of resources.

Financial statements

- ▶ As of 18th August 2015 we expect to issue an unqualified opinion on the financial statements. Our audit results demonstrate, through the few matters we have to communicate, that the Council has prepared its financial statements adequately.

Value for money

- ▶ We expect to conclude that you have made appropriate arrangements to secure economy, efficiency and effectiveness in your use of resources.

Whole of Government Accounts

- ▶ We will undertake our work on the Whole of Government Accounts return following the completion of our work on the Council's financial statements. It is likely that the Council will be below the materiality threshold set by the National Audit Office (NAO) and therefore the audit work required will be minimal. We will update Members of the Audit and Risk Committee in the unlikely circumstance that significant issues arise from this work.

Audit certificate

- ▶ The audit certificate is issued to demonstrate that the full requirements of the Audit Commission's Code of Audit Practice have been discharged for the relevant audit year. We expect to issue the audit certificate at the same time as the audit opinion.

Section 2

Extent and purpose of our work

Extent and purpose of our work

The Council's responsibilities

- ▶ The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.
- ▶ The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Purpose of our work

- ▶ Our audit was designed to:
 - ▶ Express an opinion on the 2014/2015 financial statements and the consistency of other information published with them
 - ▶ Report on an exception basis on the Annual Governance Statement
 - ▶ Consider and report any matters that prevent us being satisfied that the Council had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the Value for Money conclusion)
 - ▶ Discharge the powers and duties set out in the Audit Commission Act 1998 and the Code of Audit Practice

In addition, this report contains our findings related to the areas of audit emphasis and any views on significant deficiencies in internal control or the Council's accounting policies and key judgments.

As a component auditor, we also follow the NAO group instructions and report the results on completion of the WGA work through the Assurance Statement to the NAO and to the Council..

This report is intended solely for the information and use of the Council. It is not intended to be and should not be used by anyone other than the specified party.

Section 3

Addressing audit risks

Addressing audit risks – significant audit risks

We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the audit of the financial statements is an inherent risk with both a higher likelihood of occurrence and a higher magnitude of effect should it occur and which requires special audit consideration. For significant risks, we obtain an understanding of the entity's controls relevant to each risk and assess the design and implementation of the relevant controls.

Audit risk identified within our audit plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risks)		
<p>1. <u>Assessment of the BCKL&WN group boundary</u> IFRS 10: Consolidated Financial Statements and IFRS 11: Joint Arrangements have been adopted into the Local Authority Accounting Code of Practice for the first time in 2014/15. These new accounting standards introduced into the Code a number of changes to the classification and accounting requirements for potential group entities. The Council are therefore required to continue to revisit on an annual basis its assessment of the group boundary, especially in the light of these new standards.</p> <p>During recent years the Council has entered into a number of arrangements with other entities regarding service delivery, most significantly: Nar Ouse Regeneration Agreement (NORA); Alive Leisure Trust (ALT); and Alive Management Limited (AML)</p>	<p>We assessed where overall control lies with regard to the operation and delivery of services of potential group bodies.</p> <p>In relation to those bodies that are identified as being within the Council's group boundary, we:</p> <ul style="list-style-type: none"> ➤ assessed whether the bodies have been correctly classified and accounted for in accordance with IFRS 10 and 11; and ➤ Scoped the group audit requirements for those entities that are within the group boundary based on their significance to the group accounts. For those significant entities not audited by EY; liaised with the external auditors of those entities, issuing them with group audit instructions that detail the required audit procedures that we required them to undertake to provide us with assurance. ➤ for each body ensured that the accounting framework and accounting policies are aligned to those of the BCKL&WN group and ensuring that appropriate consolidation procedures have been applied. 	<p>The Council concluded that under IFRS 11 a joint venture relationship exists between the Council and NORA and that this relationship would be accounted for using the equity method within the Council's group accounts. The Council concluded that under IFRS 10 the relationship with AML is one of parent and subsidiary as the Council holds 100% shareholding and the subsidiary has been fully consolidated within the group accounts. The Council concluded that under IFRS 10 and 11 the relationship between them and ALT is outside of the group boundary. We reviewed management's assessment of its group boundary and concurred with the conclusions drawn.</p> <p>We have contacted and are awaiting assurances from the subsidiary auditor for AML, Ensors, with regard to the significant balances consolidated within the group statements.</p> <p>We have completed our procedures to confirm that the accounting framework and policies are aligned. No issues arise.</p>

Addressing audit risks – significant audit risks (cont'd)

- ▶ We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

Audit risk identified within our Audit Plan	Audit procedures performed	Assurance gained and issues arising
<p>Significant audit risks (including fraud risks)</p> <p>2. <u>Management override</u> As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p>	<ul style="list-style-type: none"> ▶ Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; ▶ Reviewed accounting estimates for evidence of management bias; and ▶ Evaluated the business rationale for any significant unusual transactions. 	<p>Our planned procedures in relation to this risk are complete. There are no issues to report to the Committee</p>

Section 4

Financial statements audit – issues and findings

Financial statements audit – issues and misstatements arising from the audit

Progress of our audit

- ▶ The following areas of our work programme remain to be completed. We will provide an update of progress at the Audit and Risk Committee meeting:
 - ▶ Verification that the agreed audit amendments have been made to the final version statement of accounts
 - ▶ Response to group instructions and conclusion on agreed procedures from AML's auditors
 - ▶ Receipt of a Letter of Representation
- ▶ Subject to the satisfactory resolution of the above items, we propose to issue an unqualified audit report on the financial statements.

Uncorrected misstatements

- ▶ We have identified one misstatement within the draft financial statements, which management has chosen not to adjust.
- ▶ We ask the Audit Committee to consider approving management's rationale as to why these corrections have not been made and, if approved, include this in the Letter of Representation.
- ▶ Appendix A to this report sets out the uncorrected misstatement.

Corrected misstatements

- ▶ Our audit identified a number of further misstatements which our team have highlighted to management for amendment. These have been corrected during the course of our work. None of these are considered significant enough to warrant reporting to Members.

Other matters

- ▶ As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Authority's financial reporting process including the following:
 - ▶ Qualitative aspects of your accounting practices; estimates and disclosures;
 - ▶ Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions;
 - ▶ Any significant difficulties encountered during the audit; and
 - ▶ Other audit matters of governance interest

We have one matter we wish to report:

The Council's bank reconciliation included a £1,041k reconciling item. Further details are provided on the following page.

In addition to this issue, the Council encountered a number of other accounting difficulties arising from the establishment of Alive Management Limited and Alive Leisure Trust. For example, the year end sundry debtors report included all three entities and this report had to be manually split out by the financial services team between the Council, AML and ALT. Whilst these difficulties were satisfactorily resolved, they resulted in some extra effort preparing the accounts and also some extra audit work.

Financial statements audit – other matters

Bank Reconciliation

During closedown procedures, financial services identified an error within the bank control account at year end, resulting in an overstatement of cash at bank in the draft financial statements of £1,041k. This error was identified through bank reconciliation procedures. To ensure that the control account was not amended, an adjustment was made to the debtor balance to offset the identified overstatement in the cash balance, resulting in the current asset total in the balance sheet being correct.

We undertook procedures to identify and understand this error which was identified through the bank reconciliation process, in order to conclude on the appropriateness of the correcting entries.

Our procedures identified that the error was made up of two transactions of the same value of £520k. The first was an incorrect adjustment which increased cash and reduced debtors to account for an amount owed to the Council by Alive Management Limited (this adjustment was incorrect as this amount had been settled by AML with the Council). When this first incorrect adjustment was identified, financial services processed a second transaction designed to reverse that error, however this second adjustment was incorrectly made, having the effect of actually doubling the original error.

We have agreed an adjustment with management to correct this error by reducing the cash balance and increasing the debtor balance in the financial statements by £1,041k.

Our audit procedures in regards to this risk are now complete. There are no further issues to report to the committee.

Financial statements audit – application of materiality

Our application of materiality

- ▶ When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	
<p>Planning Materiality and Tolerable error</p>	<p>We determined planning materiality to be £1.6 million (2014: £1.7 million), which is 2% of gross expenditure reported in the accounts of £78 million adjusted for parish precepts, levies, pooling of housing capital receipts and interest payable. We determined group planning materiality to be £1.7m using the same basis as above.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p> <p>We set a tolerable error for the audit. Tolerable error is the application of planning materiality at the individual account or balance level. It is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality. The level of tolerable error drives the extent of detailed audit testing required to support our opinion.</p> <p>We have set tolerable error at the lower level of the available range because there were a number of material and significant corrected errors in the prior year financial statements.</p>
<p>Reporting Threshold</p>	<p>We agreed with the Audit and Risk Committee that we would report to the Committee all audit differences in excess of £84k (2014: £86k). We have set the group audit difference threshold as £85k.</p>

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits. Strategy applied : verification of all disclosures made.
- Related party transactions. Strategy applied : verification of all disclosures made.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

Financial statements audit – internal control, written representations and whole of government accounts

Internal control

- ▶ It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.
- ▶ We have tested the controls of the Council only to the extent necessary for us to complete our audit. We are not expressing an opinion on the overall effectiveness of internal control.
- ▶ We have reviewed the Annual Governance Statement and can confirm that:
 - ▶ It complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
 - ▶ It is consistent with other information that we are aware of from our audit of the financial statements.
- ▶ We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

Request for written representations

- ▶ We have requested a management representation letter to gain management's confirmation in relation to a number of matters. In addition to the standard representations, we have requested a specific representations in regards to heritage assets and their valuation.

Whole of Government Accounts

- ▶ Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.
- ▶ It is likely that the Council will be below the materiality threshold set by the National Audit Office (NAO) and therefore the audit work required will be minimal. We will update Members of the Audit and Risk Committee in the unlikely circumstance that significant issues arise from this work.

Section 5

Arrangements to secure economy, efficiency and effectiveness

Arrangements to secure economy, efficiency and effectiveness

The Code of Audit Practice (2010) sets out our responsibility to satisfy ourselves that Borough Council of King's Lynn and West Norfolk has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In examining the Council's corporate performance management and financial management arrangements, we have regard to the following criteria and focus specified by the Audit Commission.

Criteria 1 – arrangements for securing financial resilience

- ▶ 'Whether the Authority has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future'
- ▶ Since issuing our Audit Plan on 24 March, we have identified a significant risk in relation to this criteria:
- ▶ In the Council's Financial Plan 2014/18, approved in February 2015, the Council identified a cumulative budget gap of £1 million over the next three years. The Financial Plan is based on a number of assumptions, including an estimate of the future levels of Government funding. The Financial Plan currently places reliance on £3.3 million of funding from New Homes Bonus in 2016/17 and 2017/18 and a planned use of reserves of £2.1million in 2017/18 to fund the base budget. Any reduction in Government funding in future years, together with an increased use of reserves represents a risk to achievement of the Council's future budgets.
- ▶ This risk reflects the size of the budget gap the Council is facing over the next few years, as a result of reduced funding and increasing demands for services. This is in line with the challenges being faced by many other council's across the country.
- ▶ We have now completed our work in this area and have concluded that the Council has adequate arrangements in place for securing financial resilience. We set out how we addressed the identified risk on the next page.

Criteria 2 – arrangements for securing economy, efficiency and effectiveness

- ▶ 'Whether the Authority is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity'
- ▶ We did not identify any significant risks in relation to this criteria
- ▶ We have no issues to report in relation to this criteria.
- ▶ Our work did not identify any other matters relating to aspects of your corporate performance and financial management framework which are not covered by the scope of the two specified criteria above.

Addressing audit risks – significant VFM risks

As detailed on page 15 we identified a significant risk after completion of planning procedures. Here, we set out how we have gained audit assurance over this risk.

A significant audit risk in the context of the value for money conclusion is the risk that the auditor may issue the wrong value for money conclusion. Where auditors identify a significant value for money conclusion risk they will need to undertake additional audit work to enable them to reach an appropriate conclusion.

VFM risk identified	Audit procedures performed	Assurance gained and issues arising
<p>Financial Resilience</p> <p>In the Council's Financial Plan 2014/18, approved in February 2015, the Council identified a cumulative budget gap of £1 million over the next three years. The Financial Plan is based on a number of assumptions, including an estimate of the future levels of Government funding. The Financial Plan currently places reliance on £3.3 million of funding from New Homes Bonus in 2016/17 and 2017/18 and a planned use of reserves of £2.1million in 2017/18 to fund the base budget. Any reduction in Government funding in future years, together with an increased use of reserves represents a risk to achievement of the Council's future budgets.</p>	<p>We considered the following factors in relation to the risk identified :</p> <ul style="list-style-type: none"> ▶ The Council's historic financial performance, including its ability to deliver challenging savings targets; ▶ The Council's current financial position and level of reserves; ▶ The Council's processes for setting its budget, and the nature of the budget assumptions; ▶ The competency of the Council's finance team; and ▶ The political stability of the Council. 	<p>The Council's track record of achieving savings and high level of general fund reserves, which are forecast to remain above the required minimum level over the period of the Financial Plan 2014/18, reduce the risk of the Council failing to effectively set and achieve its budgets over the medium term. The Council should continue to identify the savings necessary to reduce the 2017/18 budget gaps and progress the service delivery reviews to minimise the use of reserves over the longer term.</p>

Section 6

Independence and audit fees

Independence and audit fees

Independence

- ▶ We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan dated 24 March 2015.
- ▶ We complied with the Auditing Practices Board's Ethical Standards for Auditors and the requirements of the Audit Commission's Code and Standing Guidance. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.
- ▶ We confirm that we are not aware of any relationships that may affect the independence and objectivity of the firm that we are required by auditing and ethical standards to report to you.
- ▶ We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Audit and Risk Committee on 7th September 2015.

- ▶ We confirm that we have met the reporting requirements to the Audit and Risk Committee, as 'those charged with governance' under International Standards on Auditing (UK and Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements were set out in our Audit Plan of 24 March 2015.

Audit fees

- ▶ The table below sets out the scale fee and our final proposed audit fees.

	Proposed final fee 2014/2015	Scale fee 2014/2015	Variation comments
	£	£	
Audit Fee: Code work	TBC	68,388	See below
Certification of claims and returns	TBC	31,280	See below

- ▶ Our actual fee is yet to be confirmed, but is likely to be different from the scale fee due to the introduction of the group in 2014/15 and the additional procedures that we have needed to undertake to gain assurance over the group financial statements. We will discuss and agree any proposed variation with management and this will also need to be approved by Public Sector Audit Appointments (PSAA).
- ▶ We are yet to complete our work on the certification of claims and returns but our actual fee is likely to be in line with our agreed fee.
- ▶ We confirm that we have not undertaken any non-audit work outside of the Audit Commission's Audit Code requirements.

Section 7

Appendices

Appendix A – uncorrected audit misstatements

- ▶ The following misstatement has been identified during the course of our audit and in our judgement warrants communicating to you as those charged with governance.
- ▶ This item has not been corrected by management.

Balance sheet and statement of comprehensive income and expenditure

Item of account	Nature	Type	Balance sheet	Comprehensive income and expenditure statement
	Description	F, P, J	Debit/(credit)	Debit/(credit)
1. Ongoing impact of the 2012/13 uncorrected misstatement relating to a 99 year lease which had been incorrectly treated as a full disposal in 2012/13.	The correct treatment under IFRS in 2012/13 would have been to retain the asset within long term assets and create a creditor for the sale proceeds, releasing them evenly over the 99 year lease. In 2014/15 this impacts:	F		
	Investment property		497	
	Short term lease liability		(5)	
	Long term lease liability		(431)	
	Reserves		(56)	
	Income from investment Property			(5)
Cumulative effect of uncorrected misstatement			5	(5)

Key

- ▶ F – Factual misstatement
- ▶ P – Projected misstatement based on audit sample error and population extrapolation
- ▶ J – Judgemental misstatement

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ED None

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