Report to	Audit committee	**Item**
	22 November 2016	5
Report of	Chief finance officer	
Subject	Annual audit letter 2015-16	

Purpose

This report presents the annual audit letter.

Recommendation

The committee is asked to review and note the attached report from the council's external auditor.

Corporate and service priorities

The report helps to meet the corporate priority value for money services.

Financial implications

There are no direct financial implications arising from this report.

Ward/s: All wards

Cabinet member: Councillor Stonard – Resources and business liaison

Contact officers

Justine Hartley, chief finance officer 01603 212440

REPORT

Background

1. The annual audit letter communicates to the members of Norwich City Council the key issues arising from the audit work carried out for the year ended 31 March 2016 by our external auditors. The letter is brought to the attention of all members and is also made available to external stakeholders, including members of the public, by publication on the council's website alongside the statement of accounts.

Key Findings, control themes and observations

2. The detailed findings of the audit work were reported to this committee on 20 September 2016 in the 2015-16 Audit Results Report. The key findings, control themes and observations contained in the letter are based on the findings in the audit results report.

Looking Ahead

3. The "Focused on your future" section of the letter draws attention to possible issues arising following the EU referendum result. It also reflects the setting up of Norwich Regeneration Ltd which in future years will require its own accounts to be audited and consolidated into the council's accounts.

Fees Update

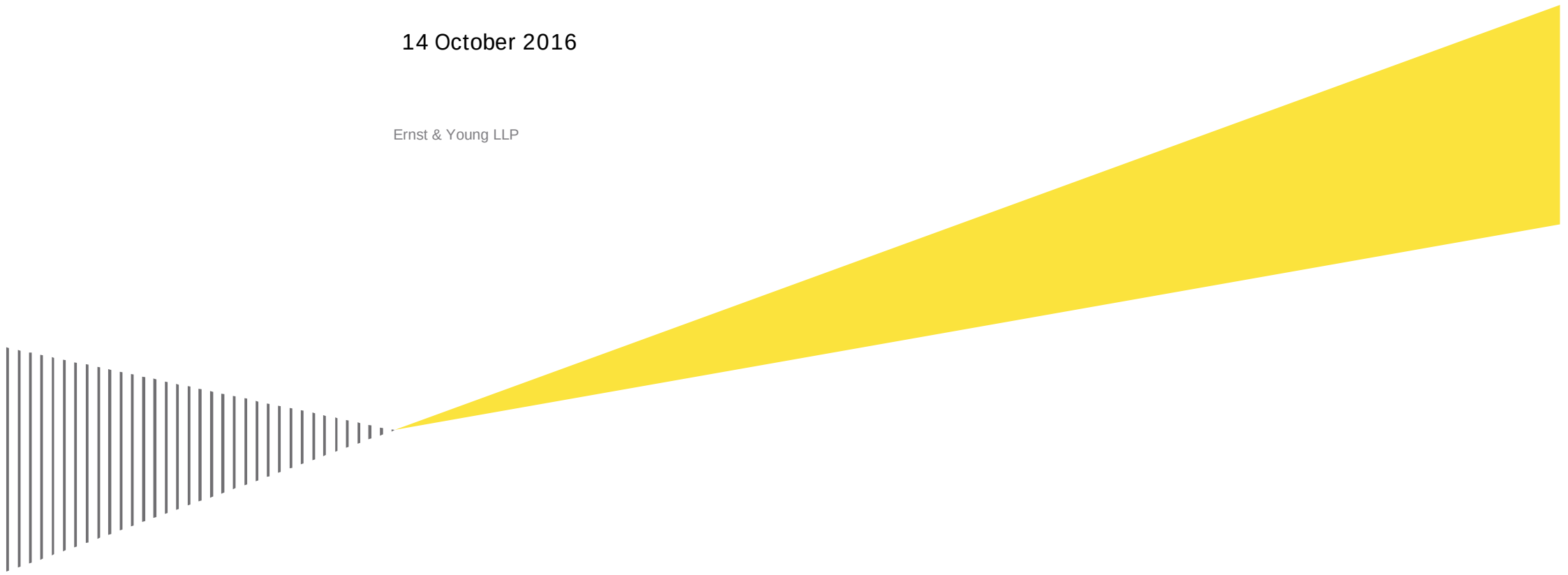
4. The audit committee should note the audit fees for the 2015-16 Statement of Accounts, are equivalent to the scale fees, plus an additional fee for work on the council's change to its minimum revenue provision policy. This policy change resulted in significant savings to the council. The committee should also note the fee proposed for the certification of claims and returns.

Norwich City Council

Annual Audit Letter for the year ended 31 March 2016

14 October 2016

Ernst & Young LLP



Building a better working world

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ‘‘Statement of responsibilities of auditors and audited bodies 2015-16’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Norwich City Council (the Council) following completion of our audit procedures for the year ended 31 March 2016.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2016 and of its expenditure and income for the year then ended.
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 12 September 2016.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 20 September 2016.

In January 2017 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken. We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Mark Hodgson
Executive Director
For and on behalf of Ernst & Young LLP

Purpose
Work

Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2015/16 Audit Results Report to the 20 September 2016 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned 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.

Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 15 March 2016 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2015/16 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the return.

Financial Statement
Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 20 September 2016.

Our detailed findings were reported to the 20 September 2016 Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Property, plant and equipment valuations We have commented in previous years on weaknesses in the spreadsheets used as a fixed asset register. The Council have continued to use these spreadsheets during 2015/16. The register is difficult to use and does not produce quality management information. This has contributed to errors and increased audit testing of valuations in previous years. Due to the complexity in accounting for property, plant and equipment and the material values involved, these weaknesses increase the risk that asset valuations and contain material misstatements. The valuation risk is increased with the prospective application of IFRS13 Fair Value Measurement from 1 April 2015. This is likely to have the largest impact on the Council's investment property portfolio where asset valuations need to be reviewed to ensure they are based on best use.	We reviewed and relied on management's valuation experts, including comparison to industry valuation trends and reliance on our own valuation experts where significant unexplained variations were identified. We tested the accounting treatment of valuations made in the year, including the assessment and treatment of impairments; and we reviewed and tested the Council's application of IFRS13 to ensure the fair value of relevant assets is based on economic best interest. We have gained sufficient assurance over the property, plant and equipment valuations and disclosures. We have no matters to report.

Significant Risk	Conclusion
Pensions valuations and disclosures The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. The Council's current pension fund deficit is a highly material and sensitive item and the Code requires that this liability be disclosed on the Council's Balance Sheet. The information disclosed is based on the IAS19 report issued to the Council by the actuaries to the Norfolk Pension Fund. As part of their actuarial review, councils are being asked to make additional payments to the pensions scheme to fund deficits.	We liaised with the auditors of the Norfolk Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Norwich City Council. We assessed the conclusions drawn on the work of the actuary by the Consulting Actuary commissioned by Public Sector Auditor Appointments, PwC; and we reviewed and tested the accounting entries and disclosures made in relation to pension valuations and disclosures. We have gained sufficient assurance over the pension valuations and disclosures. We have no matters to report.
Risk of fraud in revenue and expenditure recognition Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation. We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end. For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.	We reviewed and tested revenue and expenditure recognition policies. We reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias. We tested material revenue (grant funding, sundry debtors, council tax , non domestic rates and housing revenue account rents) and expenditure streams (sundry creditors, housing benefits and payroll costs). We reviewed and tested revenue cut-off at the period end date. Our testing has not revealed any material misstatements with respect to revenue and expenditure recognition. Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the Council's financial position. We tested the additions to the Property, Plant and Equipment balance to ensure that they are properly classified as capital expenditure. Our testing did not identify any expenditure which had been inappropriately capitalised.

Significant Risk	Conclusion
Management override of controls A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.	We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. We reviewed accounting estimates for evidence of management bias; and we evaluated the business rationale for any significant unusual transactions. We have not identified any material weaknesses in controls or evidence of material management override. We have not identified any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.

Other Key Findings	Conclusion
Assessment of the group boundary The Council is entering into new contracts and partnerships in the delivery of services. The nature of these arrangements need to be assessed to determine whether they create functional bodies and other group entities which now fall within the group boundary and therefore require consolidating into the Council's Financial Statements.	We reviewed the Council's assessment of where overall control lies and consideration of materiality with regard to the operation and delivery of services of the potential group bodies and we ensured that appropriate consolidation procedures are applied to those bodies where required. We concluded that Norwich Regeneration does fall within the Council's group boundary. However, on the grounds of materiality (both quantitative and qualitative) consolidation is not required within the 2015/16 financial statements and therefore group accounts were not required.
Existence of plant and equipment assets The Council had vehicle and equipment assets of £26.7 million at 31 March 2015. These assets tend to be more mobile and generally have a shorter useful life. The weaknesses in the fixed asset system result in increased risk that assets recorded on the balance sheet are no longer used or owned by the Council.	We reviewed the Council's controls concerning asset verification, and we carried out testing of assets for continuing existence. We have gained sufficient assurance over the existence of plant and equipment assets. We have no matters to report.

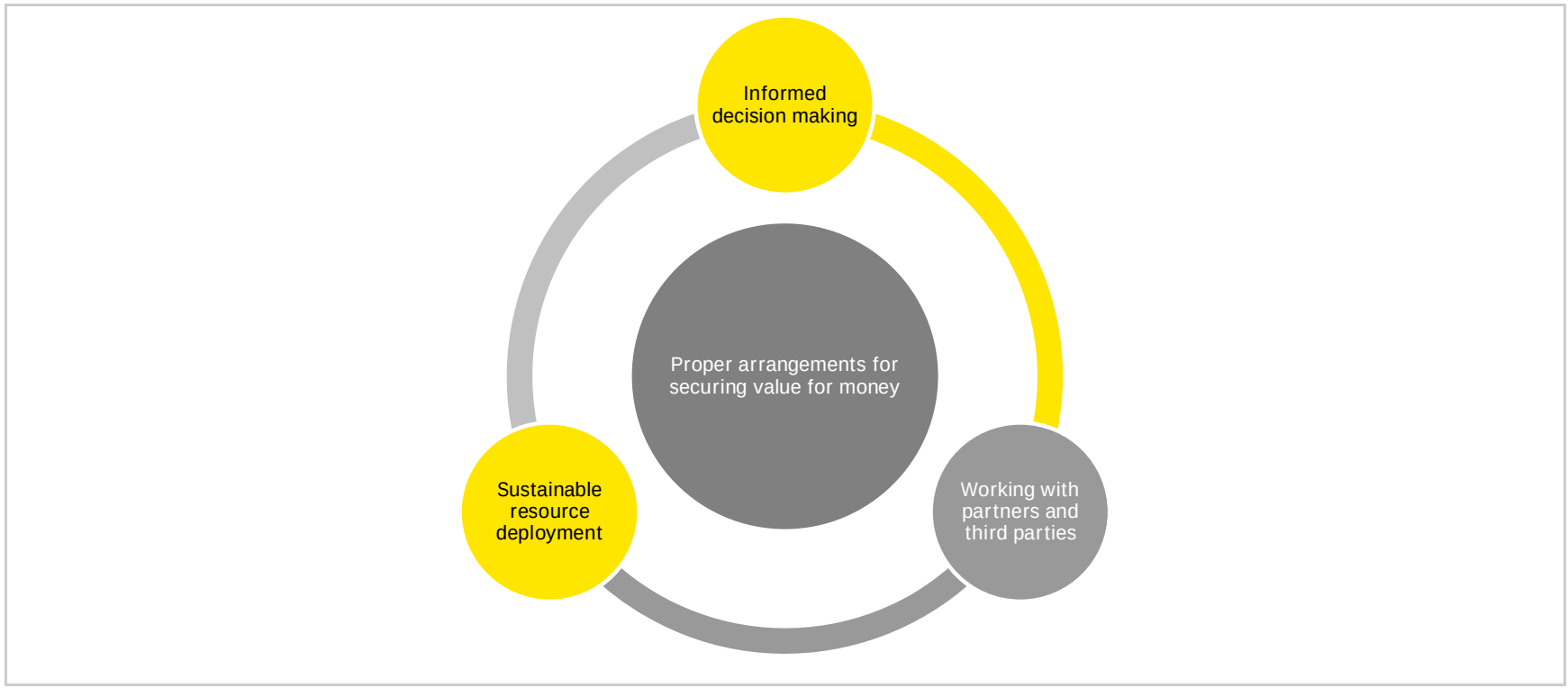
Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We issued an unqualified value for money conclusion on 20 September 2016.

Our audit did not identify any significant matters in relation to the Council's arrangements. We did however identify the following areas to bring to your attention.

Key Findings

Deploying resources in a sustainable manner

Risk

The medium term financial strategy included a £4.6 million budget gap for 2017/18 and 2018/19, this was on top of £3.7 million transformation savings/income to be delivered in in the 2016/17 budget. Although the Council has assessed the savings/income for 2016/17, there remained a risk that they are not achievable at the planned level. In addition, further savings or increased income need to be identified to close the funding shortfall in 2017/18 and 2018/19.

Findings

- The Council has a track record of achieving its planned level of annual savings and budget over the past 3 years.
- The Council currently has a high level of general fund reserves. These are £12.1 million at 31 March 2016, which is significantly above the minimum levels set by the Council's s151 officer of £4.5 million. These provide the Council with the flexibility to manage its financial position over the short-to-medium term, and reduce the risk that an unexpected overspend, or unexpected one-off item of expenditure, would have a detrimental impact on the Council's financial standing.
- Whilst there is a significant planned use of general fund reserves (£4.5 million) over the next 4 years to support the general fund budget, the remaining planned general fund reserve balance remain above the Council's approved minimum level.
- The Council's medium term financial strategy shows a need to make further net savings of £10.3 million over the next 5 years. The Council continue to work on developing proposals for additional savings to bridge the medium-term budget gap.
- The Council has appropriate processes for setting its budget, and the budget assumptions appear reasonable.

Challenges for the next year

The Council have made significant savings in prior years, but will have limited opportunity to make further savings through service re-design alone; work is currently underway to review the Council's strategy and priorities.

The Council have taken the option to secure greater certainty and confidence in funding levels through the offer of a four year funding settlement for Local Authorities for 2016-17 to 2019-20, by submitting a four year efficiency plan.

Indicative revenue support grant will reduce from £2.567 million in 2016/17 to £0.213 million in 2019/20. There is also uncertainty around other Council funding streams, the New Homes Bonus grant and the move to the retention of 100% of business rates.
The latest published MTFS up to 2021/22 was approved by council on 23rd Feb 2016 and sets a net savings requirement for the council of £2.3m pa for the next 4 years reducing to £1.1m in 2021/22.

Deploying resources in a sustainable manner

Risk

The Council have assessed that the impact of legislation on HRA rent levels would require the Council to borrow above its borrowing cap. The Council also anticipates that further changes in the Housing and Planning Bill 2015/16 would increase right to buys and reduce housing stock.

The HRA Business Plan needs to be re-worked to reflect the impact of the proposed changes and options developed to mitigate the impact of a determination and maintain HRA borrowing below the cap.

Findings

- The Council have re-worked the HRA business plan for the 1% rent reduction.
- To offset the loss of rental income, the maintenance programme has been revised.
- Although the Council have considered various options, plans are on hold until the determination clarifies guidance going forward.
- The Council continues to assess the impact from legislation changes, and reflect agreed actions in business plans.

Challenges for the next year

The Council approved the latest HRA business plan on 23rd February 2016. This reflects the 1% annual rent reduction for social rents, and the anticipated determination required to be paid to fund right to buy sales by registered providers, as introduced in the Housing and Planning Act 2016. The business plan has removed £7 million, largely through revised maintenance budgets, but will need to identify further efficiencies, the scale of which is will not be known until the determination is confirmed.

Other Reporting
Issues

Other Reporting Issues

Whole of Government Accounts

The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2015/16 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

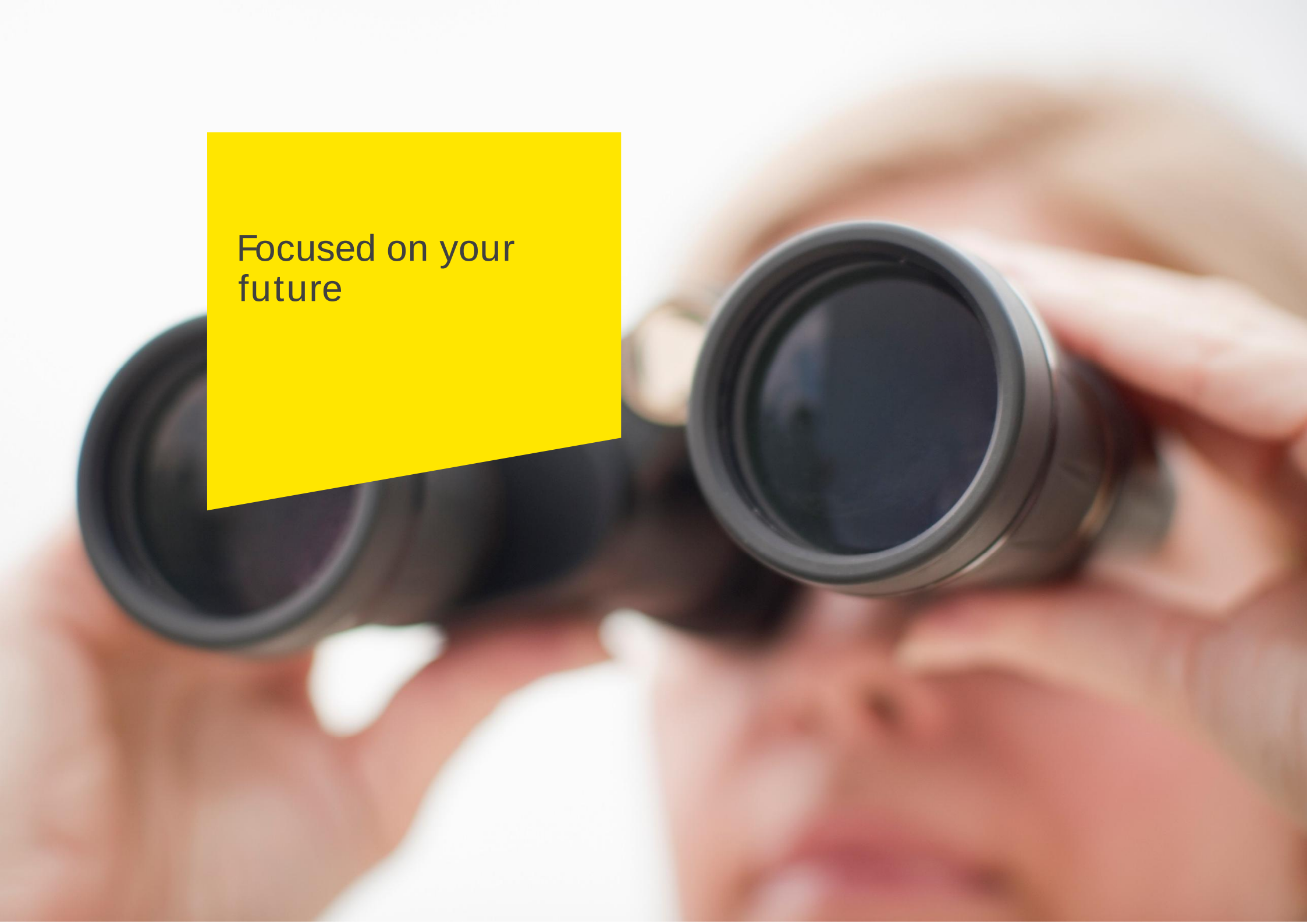
We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 20 September 2016. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have tested the controls of the Council only to the extent necessary for us to complete our audit. We have not identified any issues with testing of payroll controls.

We have adopted a fully substantive approach for other key processes and have therefore not tested the operation of controls.


Focused on your
future

Focused on your future

Area	Issue	Impact
EU referendum	Following the majority vote to end the UK's membership of the European Union (EU) in the EU Referendum held on 23 June 2016 there is a heightened level of volatility in the financial markets and increased macroeconomic uncertainty in the UK. All three major rating agencies (S&P, Fitch and Moody's) took action on the UK Sovereign credit rating and, following the rating action on the UK Government. For entities in the public sector, there is likely to be an impact on investment property valuations if confidence in the wider UK property market falls; and the valuation of defined benefit pension obligations may also be affected. It is too early to estimate the quantum of any impact of these issues, but there is likely to be significant ongoing uncertainty for a number of months while the UK renegotiates its relationships with the EU and other nations.	Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of the referendum and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions. We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will engage with you on the concerns and questions you may have, provide our insight at key points along the path, and provide any papers and analysis of the impact of the referendum on the Government and Public Sector market.
Local housing development company	The Council has established a local housing development company (Norwich Regeneration Company) to build, sell and manage houses for sale and rent. The company is a wholly owned subsidiary of the Council.	The setting up of a council owned company requires the Council to consider legal powers, contracting arrangements, governance structures, risk management, financial modelling and accounting implications. We have acted as a critical friend in the setting up of the company, reviewing committee papers and meeting with Council officers to discuss our experience of similar ventures. We will work with the Chief Financial Officer to work through accounting implications in 2016/17.

Appendix A

Audit Fees

Appendix A Audit Fees

Our fee for 2015/16 is in line with the scale fee set by the PSAA and reported in our 12 September 2016 Audit Plan Results Report.

Description	Proposed Final Fee 2015/16 £'s	Scale Fee 2015/16 £'s
Total Audit Fee – Code work	83,596 See Note 1	79,914
Total Audit Fee – Certification of claims and returns	See Note 2	35,780

Note 1 - We have undertaken a review of the Council's approach to the Minimum Revenue Provision. This additional work has an additional fee of £3,682 and is currently subject to approval by Public Sector Audit Appointments Ltd (PSAA).

Note 2 - Certification of claims and returns. We have not commenced our work in this area. We will report the results of our work and the final fee with you in our Annual Certification Report.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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ED None

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Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

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