



# SOUTHEND-ON-SEA BOROUGH COUNCIL

## ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2016



# EXECUTIVE SUMMARY

## Purpose of the letter

This Annual Audit Letter summarises the key issues arising from the work that we have carried out in respect of the financial year ended 31 March 2016. It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public. It will be published on the website of Public Sector Audit Appointments Limited.

## Responsibilities of auditors and the Council

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's Code of Audit Practice (the Code), and to review and report on:

- the Council's financial statements
- whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are also required to report where we have exercised our statutory powers under the Local Audit and Accountability Act 2014 in any matter and our grant claims and returns certification work.

We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the audit.

**BDO LLP**  
28 October 2016

## Audit conclusions

### FINANCIAL STATEMENTS

We issued an unqualified true and fair opinion on the financial statements on 30 September 2016.

We reported our detailed findings to the Audit Committee on 21 September. We reported on uncorrected misstatements which management and the Audit Committee concluded were immaterial.

### USE OF RESOURCES

We issued an unqualified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 30 September 2016.

While there is a recognised funding gap in the Medium Term Financial Strategy (MTFS), we are satisfied that the Council has appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.

### EXERCISE OF STATUTORY POWERS

We have not exercised our statutory powers and have no matters to report.

### GRANT CLAIMS AND RETURNS CERTIFICATION

Our review of grant claims and returns is in progress and the results will be reported upon completion of this work.

# FINANCIAL STATEMENTS

## OPINION

We issued an unqualified true and fair opinion on the financial statements on 30 September 2016.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes an assessment of whether the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates, and the overall presentation of the financial statements.

### Our assessment of risks of material misstatement

Our audit was scoped by obtaining an understanding of the Council and its environment, including the system of internal control, and assessing the risks of material misstatement in the financial statements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing of the efforts of the audit team.

| MANAGEMENT OVERRIDE OF CONTROLS  | RESPONSE  | FINDINGS  |
|--|---|---|
| <p>Auditing standards presume that a risk of management override of controls is present in all entities.</p> <p>By its nature, there are no controls in place to mitigate the risk of management override.</p> | <p>We responded to this risk by reviewing the appropriateness of journal entries and other adjustments to the financial statements.</p> <p>We also reviewed accounting estimates for evidence of possible bias and obtained an understanding of the business rationale of significant transactions that appeared to be unusual.</p> | <p>No issues were identified in our review of the appropriateness of journal entries and other adjustments made to the financial statements.</p> <p>We identified one non material unadjusted error in relation to the calculation of the bad debt provision, we did not consider this to be as a result of bias.</p> |

# FINANCIAL STATEMENTS

## Continued

| REVENUE RECOGNITION  | RESPONSE  | FINDINGS  |
|--|---|---|
| <p>Auditing standards presume that there are risks of fraud in revenue recognition. These risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue.</p> <p>In particular, we considered there to be a significant risk in relation to the completeness and existence of fees and charges in the Comprehensive Income &amp; Expenditure Statement (CIES).</p>  | <p>We carried out a review of revenue recognition that focused on testing completeness and existence of fees and charges across all service areas within the CIES. We substantively tested an extended sample of fees and charges to supporting documentation to confirm that income had been accurately recorded and earned in the year.</p> <p>We substantively tested an extended sample of receipts either side of the year end to ensure that income was complete and accounted for in the correct period.</p> <p>Testing was completed on revenue streams which are generated at the provision of a service to customers in order to gain assurance that income was materially complete and accurate.</p> | <p>No non-trivial issues were identified by our testing of revenue from fees and charges.</p>   |
| HRA PROPERTY REVALUATIONS  | RESPONSE  | FINDINGS  |
| <p>Local authorities are required to ensure that the carrying value of property, plant and equipment (PPE) is not materially different to the fair value at the balance sheet date. The Code requires management to carry out a full valuation of its land and buildings on a periodic basis (at least every 5 years). In the intervening years, management is required to assess whether there has been a material change in the value of its assets which should be accounted for.</p> <p>As part of the 5 year rolling revaluation programme, all HRA property assets were revalued in 2015/16. Upon review of these revaluation schedules during the audit planning, we identified that the upward revaluation of HRA properties totalled £40m and downward revaluation totalled £37m. Of the £37m downward movement, £16m was the write off of generic capital expenditure items for which there appeared to be a reasonable explanation. However, current market conditions for property led us to expect only upward revaluations and so the remaining downward revaluation movement of £21m was contra to our expectations and judged to be indicative of potential material misstatement.</p> | <p>We reviewed the instructions provided to the valuer and reviewed the valuer's skills and expertise in order to determine that we could rely on the management expert.</p> <p>We reviewed the basis of valuation for assets valued in year to ensure it was appropriate based on their usage.</p> <p>We performed a comparison of the values applied to a sample of HRA properties against the values for which equivalent properties were sold for in the private housing market.</p>  | <p>Our comparison work on the values applied to each of the HRA properties sampled against the values for which equivalent properties were sold in the private housing market indicated that the values applied to all sampled properties were appropriate.</p> <p>We were satisfied that property valuations were materially correct and the basis of valuation for assets valued in the year was appropriate.</p> <p>We concluded that we were able to rely on the Council's management expert.</p> |

# FINANCIAL STATEMENTS

## Continued

| INDEXATION OF PROPERTY, PLANT AND EQUIPMENT   | RESPONSE   | FINDINGS  |
|---|--|---|
| <p>Local authorities are required to ensure that the carrying value of property, plant and equipment (PPE) is not materially different to the fair value at the balance sheet date. The Code requires management to carry out a full valuation of its land and buildings on a periodic basis (at least every 5 years). In the intervening years, management is required to assess whether there has been a material change in the value of its assets which should be accounted for.</p> <p>The Council determined that there was a material change in the value of some of their assets in 2015/16 and applied an indexation uplift to account for this change. The percentage increases applied by the Council are determined by class of asset with the highest percentage applied being 8%. However current market conditions for property lead us to believe that a number of assets will have increased in value by more than 8%. Some of the percentages applied are therefore contra to our expectations and were judged to be indicative of potential material misstatement.</p> | <p>We responded to this risk by reviewing the instructions provided to the valuer and reviewed the valuer's skills and expertise in order to determine that we could rely on the management expert to calculate these indices.</p> <p>We reviewed the indices applied by the Council, and confirmed that the basis used for calculating them was appropriate.</p> <p>We reviewed valuation movements against indices of price movements for similar classes of assets and followed up valuation movements that appeared unusual against indices.</p> | <p>Our review of the indices applied confirmed that all indices were either in line with expectations against the price movements for similar classes of assets or were within a tolerable variance of these price movements.</p> <p>No issues were identified from our testing, with all indices applied concluded to be reasonable.</p> |

| PENSION LIABILITY  | RESPONSE   | FINDINGS  |
|--|--|---|
| <p>The pension liability comprises the Council's share of the market value of assets held in the Essex County Council Pension Fund and the estimated future liability to pay pensions.</p> <p>An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation.</p> | <p>We reviewed the reasonableness of the assumptions applied by comparing these to the expected ranges provided by an independent consulting actuary report.</p> | <p>We were satisfied that the assumptions used were not unreasonable or outside of the expected ranges.</p> |

# FINANCIAL STATEMENTS

## Continued

### Our application of materiality

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements.

We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonably knowledgeable users that are taken on the basis of the financial statements.

Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

The materiality for the financial statements as a whole was set at £8.6 million. This was determined with reference to a benchmark of gross expenditure (of which it represents two per cent) which we consider to be one of the principal considerations for the Council in assessing the financial performance.

We agreed with the Audit Committee that we would report all individual audit differences in excess of £215,000.

### Audit differences

Our audit identified one audit difference not corrected in the final financial statements that impact on the reported surplus on the provision of services. This was for £2.575 million, being the difference between the impairment allowance for receivables calculated by the Council and the impairment allowance calculated based upon historical collection rates.

There was also one unadjusted error from the previous year that would have affected the reported surplus on the provision of services by £0.583m.

Correcting for these remaining misstatements would result in the Council reporting a £1.992 million higher surplus on the provision of services for the year.

Management and the Audit Committee consider that these misstatements did not have a material impact on the financial statements.

There were no differences that were corrected in the revised draft financial statements that affect the reported surplus for the year. However, some amendments to classifications were made, as follows:

- An adjustment of £2.5m was made to gross up the additions and disposals in respect of investing activities in the note to the cash flow statement.
- An amendment of £914,000 was made to the consolidation adjustments made to the Group Balance Sheet.
- An adjustment of £3.054m was made to the HRA income and expenditure statement in order to align it with the CIES.
- A reclassification adjustment of £48,000 was posted between the additional provisions made in the year and the amounts used in the year, in respect of the insurance provision.

### Other matters we report on

#### Annual governance statement

We are satisfied that the Annual Governance Statement is not misleading or inconsistent with other information we were aware of from our audit.

#### Narrative reporting

Local authorities are required to include a narrative report in the Statement of Accounts to offer interested parties an effective guide to the most significant matters reported in the accounts. The narrative report should be fair, balanced and understandable for the users of the financial statements.

We were satisfied that the information given in the narrative report for the financial year for which the financial statements were prepared was consistent with the financial statements.

# FINANCIAL STATEMENTS

## Continued

### Internal controls

We found two significant deficiencies in internal controls during the course of our audit.

- Payroll Amendments - Evidence to support amendments to the Payroll system (including starters, leavers and amendments to staff records) could not be found for a number of amendments during testing completed by Internal Audit. This creates a risk that incorrect or fraudulent amendments could be made. This point was previously reported by Internal Audit.
- Payroll Authorisation - The Council identified that one employee was erroneously paid £363,000 (£627,000 gross) in April 2015. Although the Council has controls in place to stop such payments taking place, these controls were ineffective and failed to stop the payment being made. We understand that the employee repaid the amount promptly.

Some other areas for improvement were identified which we have discussed with management.



# FINANCIAL STATEMENTS

## Continued

### Whole of Government Accounts

Auditors are required to review Whole of Government Account (WGA) information prepared by component bodies that are over the prescribed threshold of £350 million in any of: assets (excluding certain non current assets); liabilities (excluding pension liabilities); income or expenditure.

We completed our review in accordance with the Group Audit Instructions issued by the National Audit Office. This requires that we compare the information in the Council's Data Collection Tool (DCT) submission with the audited financial statements, undertake testing of completeness and accuracy of WGA counter party transactions and balances, and provide an assurance statement to the National Audit Office.

The DCT was amended as a result of the audit and our assurance statement was submitted on 21 October 2016.

We concluded that the DCT was consistent with the audited statutory accounts.

We reported three inconsistencies in the mapping between the accounts and the DCT:

- The totals of the usable and unusable reserves did not map directly to the final signed accounts because of the way the DCT formulae pulls through the group reserves. Without the workings of the DCT form being revised, it is not possible for the Council to accurately reflect their reserves on the balance sheet.
  - The net cost of services figure in the DCT does not map directly to the final signed accounts. This is because two grants (the New Homes Bonus and the Education services grants) are included in a different place in the DCT. In the accounts these are included in taxation and non specific grant income, however in the DCT these are included within the cost of services.
  - The debtor and creditor figures in the DCT do not map directly to the final signed accounts. This is as a result of an amendment made to the DCT at the request of the DCLG on the 21 August 2015 to correct the Council Tax/ Business Rates Debtors and Creditors. As this amendment was requested in the prior year, the Council have posted a consistent adjustment in the current year.
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# USE OF RESOURCES

## CONCLUSION

We issued an unqualified conclusion on the arrangements for securing economy, efficiency and effectiveness in its use of resources on 30 September 2016.

### Scope of the audit of use of resources

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources based on the following reporting criterion:

*In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.*

As part of reaching our overall conclusion we consider the following sub criteria in our work: informed decision making, sustainable resource deployment and working with partners and other third parties.

### Our assessment of significant risks

Our audit was scoped by our knowledge brought forward from previous audits, relevant findings from work undertaken in support of the opinion on financial statements, reports from the Council including internal audit, information disclosed or available to support the governance statement and annual report, and information available from the risk registers and supporting arrangements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing of the efforts of the audit team.

| SUSTAINABLE FINANCES  | RESPONSE   | FINDINGS  |
|---|--|---|
| Government continues to reduce funding for local government, and combined with additional pressures arising from demographic and other service delivery changes, this will have a significant impact on the financial resilience of the Council in the medium term. | <p>We reviewed the latest Medium Term Financial Strategy (MTFS) which covers the four year period to 2019/20. The Council set a balanced budget for 2016/17 but this requires planned savings of £10.1 million to be achieved. The MTFS forecasts a budget gap totalling £28.1 million over the remaining three years which will need to be funded through either savings or additional revenue in order to maintain the current general fund position. This is a reduction from the MTFS published at the end of 2014/15 year which showed a budget gap of £32.4 million. The two MTFS' cover different years and the reductions is due to the gap for 2019/20 in the current MTFS being lower than the budget gap for 2016/17 in the prior year MTFS. The budget gap is forecast to arise as follows:</p> <p>2017/18: £12.4 million (increased from £10.3 million in the previous MTFS)</p> <p>2018/19: £8.4 million (consistent with the previous MTFS)</p> <p>2019/20: £7.3 million.</p> <p>Although the current budget gap is significant the Council is aware of the importance of finding sustainable savings or new revenue streams.</p> | <p>Whilst the Council has identified a significant funding gap, action is being taken to ensure the matter is addressed and the Council has a track record of achieving its financial plans.</p> <p>Sufficient reserves and balances are available to support the Council's services in the medium term, should there be under performance against savings plans.</p> <p>Therefore, while there is a recognised funding gap in the MTFS, we are satisfied that the Council is undertaking appropriate arrangements to manage this in a way that will ensure it remains financially sustainable over the period of the MTFS.</p> |

# EXERCISE OF STATUTORY POWERS

**REPORT BY EXCEPTION**

We have not exercised our statutory powers and have no matters to report.

## Objections

We received one objection in relation to rental income from London Southend Airport Company Limited. On the basis of the amounts involved and that the Council was taking corrective action we decided not to take any further action on the grounds that the cost of us undertaking further work would be disproportionate to the sums to which the objection related. In reaching this conclusion we considered and concluded that nothing in the objection led us to have serious concerns about the way the Council is managed or led. A letter was sent to the objector on 28 September 2016.

## Audit certificate

We were unable to issue the Audit Certificate until the Whole of Government Accounts return had been completed. This was completed on 21 October 2016 in line with the revised deadline. We issued the audit certificate to close the audit for the year ended 31 March 2016 on 27 October 2016.

# GRANT CLAIMS AND CERTIFICATION

## CERTIFICATION WORK

Our review of grant claims and returns for 2015/16 is in progress and the results will be reported upon completion of this work.

### Housing benefit subsidy claim

Public Sector Audit Appointments Ltd has a statutory duty to make arrangements for certification by the appointed auditor of the annual housing benefit subsidy claim.

Our audit of the 2014/15 housing benefits subsidy claim found a number of errors identified from our testing which required further testing. Where we could not conclude that errors were isolated these were reported to the Department for Work and Pensions in the qualification letter.

Our work on the 2015/16 housing benefits subsidy claim is currently in progress and will be completed ahead of the submission deadline of 30 November 2016.

### Other claims and returns

A number of grant claims and returns that were previously included within the scope of the audit have since been removed, but Departments may still seek external assurance over the accuracy of the claim or return.

These assurance reviews are undertaken outside of our appointment by the Audit Commission or Public Sector Audit Appointments Ltd, and are covered by tripartite agreements between the Council, sponsoring Department and the auditor.

The Council has requested that we undertake a 'reasonable assurance' review, based on the instructions and guidance provided by the Departments, for the following returns for 2015/16:

- Pooled housing capital receipts (deadline 30 November 2016)
- Teachers' pensions return (deadline 30 November 2016)

Our work on these returns is currently in progress.

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# APPENDIX

## Reports issues

We have issued the following reports since our previous annual audit letter.

| REPORT   | DATE           |
|--|----------------|
| Grant claims and certification work 2014/15                                | February 2016  |
| Audit Plan   | March 2016     |
| Report to Audit Committee (ISA260 Report to those charged with governance) | September 2016 |
| Annual Audit Letter  | October 2016   |

## Fees

We reported our original fee proposals in our Audit Plan. We have not had to amend our planned fees.

| AUDIT AREA                                | PLANNED FEES   | FINAL FEES            |
|---|----------------|-----------------------|
| Code audit                                | 142,816        | 142,816               |
| Certification of housing benefits subsidy | 22,226         | <sup>(1)</sup> 22,226 |
| <b>Fee for audit services</b>             | <b>165,042</b> | <b>165,042</b>        |
| Audit related services:                   |                |                       |
| - Pooled housing capital receipts         | 2,500          | <sup>(1)</sup> 2,500  |
| - Teachers' Pension Return                | 6,950          | <sup>(1)</sup> 6,950  |
| - Objection <sup>(2)</sup>                | N/A            | 1,430                 |
| <b>Fee for audit related services</b>     | <b>9,450</b>   | <b>10,880</b>         |
| Non audit related services:               |                |                       |
| - Review of internal audit provision      | 6,000          | 6,000                 |
| <b>Total fees</b>                         | <b>180,492</b> | <b>181,922</b>        |

Note 1 - Our work on the Housing Benefit subsidy claim and the other claims and returns for 2015/16 is in progress and we will report the findings from this work and the final fees separately.

Note 2- Time spent on Objections is billed at the actual hours spent at the rates set by Public Sector Appointments Limited.

The matters raised in our report prepared in connection with the audit are those we believe should be brought to the attention of the organisation. They do not purport to be a complete record of all matters arising.. No responsibility to any third party is accepted.

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