South Oxfordshire District Council

Annual Audit Letter for the year ended 31 March 2018

October 2018

Agenda Item 6

EY

Building a better working world

Contents

Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. 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 (updated 23 February 2017)' 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.

01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to South Oxfordshire District Council following completion of our audit procedures for the year ended 31 March 2018.
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 2018 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).	We had no matters to report.

Executive Summary (cont'd)

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 21 September 2018.
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 28 September 2018.

In December 2018, we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

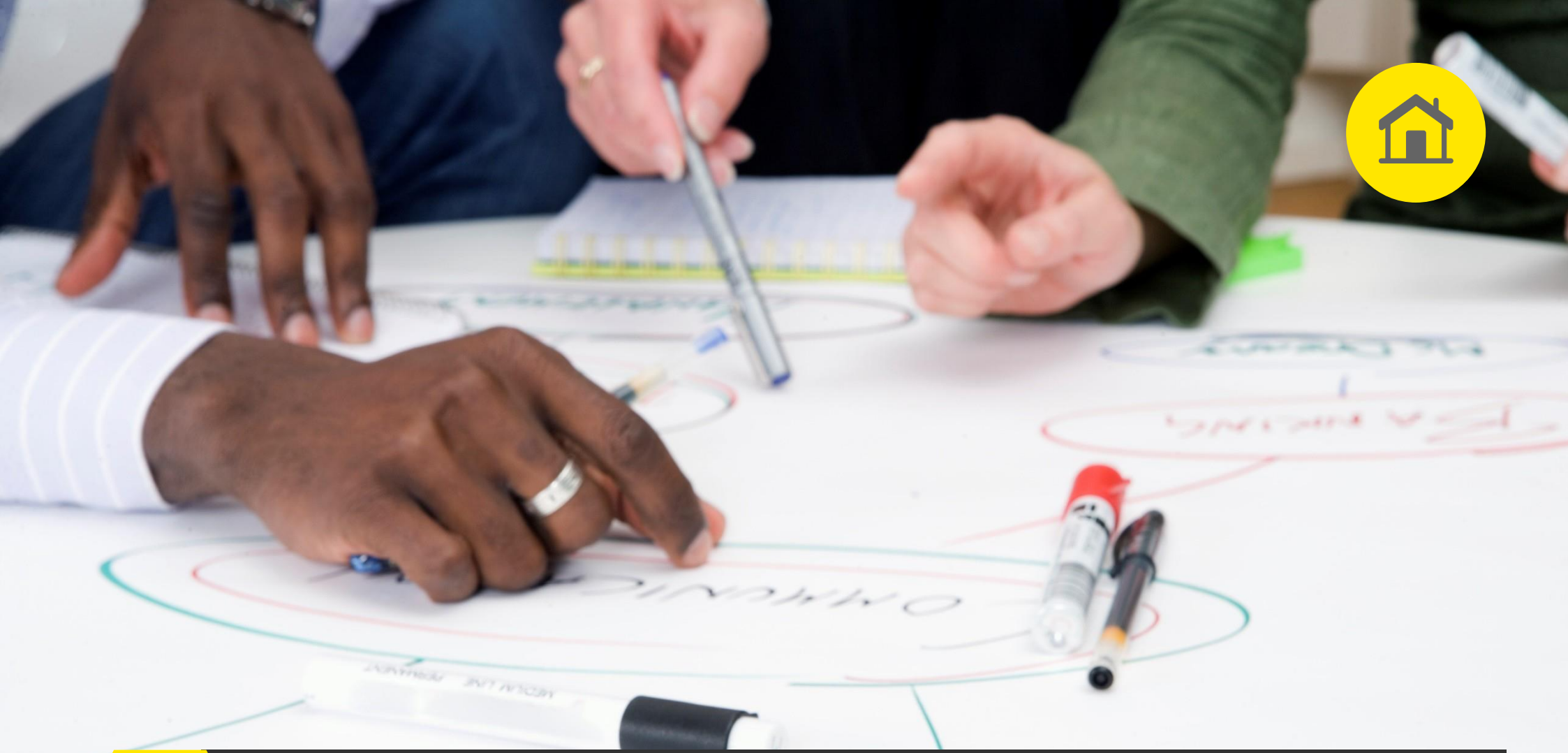
We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Yours faithfully

Andrew Brittain

Associate Partner

For and on behalf of Ernst & Young LLP



02 Purpose and Responsibilities

Purpose and Responsibilities

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 2017/18 Audit Results Report to the 27 September 2018 Joint Audit & Governance 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 of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued on 29 January 2018 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 2017/18 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 you Whole of Government Accounts return.

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.

03 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 28 September 2018.

Our detailed findings were reported to the 27 September 2018 Joint Audit & Governance Committee.

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

Significant Risk	Conclusion
Risk of fraud in revenue and expenditure recognition Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.	Procedures performed ▸ Reviewing and testing revenue and expenditure recognition policies. ▸ Reviewing and discussing with management any accounting estimates on revenue or expenditure recognition for evidence of bias. ▸ Developing a testing strategy to test material revenue and expenditure streams. ▸ Reviewing and testing cut-off at the period end date. We focused on: ▸ Understanding the controls put in place by management relevant to this significant risk ▸ Considering whether or not purchase invoices were being inappropriately classified as capital ▸ Whether management were inappropriately processing journals that transferred amounts from revenue to capital Conclusion: ▸ Our testing has not identified any material misstatements from revenue and expenditure recognition. ▸ Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Authority's financial position.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
Risk of Management Override The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK and Ireland) 240, 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. We identify and respond to this fraud risk on every audit engagement.	Procedures performed: ▸ Make enquiries of management about risks of fraud and the controls put in place to address those risks; ▸ Understand the oversight given by those charged with governance of management's processes over fraud; ▸ We tested Cash income, cash expenditure and payables cut-off. ▸ We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements; ▸ We reviewed accounting estimates for evidence of management bias; and ▸ We evaluated the business rationale for any significant unusual transactions We focused on aspects of the financial statements where management could inappropriately inflate income or understate expenditure, primarily: ▸ Material accounting estimates. ▸ Cash income, cash expenditure and payables cut-off. ▸ Revenue and expenditure recognition policies. ▸ Journal entries. ▸ Unusual transactions. Conclusion: ▸ 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 Authority's normal course of business

Financial Statement Audit (cont'd)

Other Key Findings	Conclusion
1) Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. As the Councils' asset bases are significant, and the outputs from the valuer are subject to estimation, there is a risk fixed assets may be under/overstated or the associated accounting entries incorrectly posted. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	Procedures • Consideration of the work performed by the Councils' valuer, Bruton Knowles, including the adequacy of the scope of the work performed, professional capabilities and the results of their work. • Reviewing and sample testing the key asset information used by Bruton Knowles in performing their valuation; • Consideration of the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer; • Review of the desktop review and valuations performed by management's internal valuer over assets not subject to external valuation in 2017/18 to confirm that the remaining asset base is not materially misstated; • Consideration of the changes to useful economic lives as a result of the most recent valuation; • Considering whether asset categories held at cost have been assessed for impairment and are materially correct; and • Testing that the accounting entries have been correctly processed in the financial statements, including the treatment of impairments. Conclusion The valuation methodologies and the assumptions used to calculate the asset values are deemed to be reasonable. No significant issues have been noted.
2) Pension Liability Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hertfordshire County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2018 this totalled £59.4m. The information disclosed is based on the IAS 19 report issued to the Council by the actuary. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	Procedures • Liaised with the auditors of Oxfordshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to both Councils; • Assessed the work of the Pension Fund actuary (Barnett Waddingham) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and • Reviewed and tested the accounting entries and disclosures made within the Councils' financial statements in relation to IAS19. Conclusion The actuary performed a roll forward technique to estimate the value of SODC's share of the pension scheme assets as at 31 March 2018. The actual scheme assets at year end were higher than the estimated value and the difference between the actuaries estimate and the year-end actuals was £1.185m. As the movement in the schemes assets was not material to the Council's accounts, management decided not to adjust the statements. We have assessed the work of the Pension Fund actuary Barnett Waddingham, including the assumptions they have used, as outlined above. No significant issues have been noted from the review of the assumptions used by the actuary. In conclusion, the pension scheme net liability valuation appears to be materially fairly stated.

Financial Statement Audit (cont'd)

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	Thresholds applied
Planning materiality	Given the Council provides services to local residents / businesses, using income derived from a variety of sources including taxation (for example Council Tax and National Non-Domestic Rates), fees and charges for services, and grants from central government. On this basis, our view is that the primary focus of stakeholders is likely to be on the management and control of expenditure. We therefore consider Gross Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council. We planned our procedures using a materiality of £1.45 million. We reassessed this using the year-end figures submitted for audit and these amounts changed slightly to £1.59 million. However, a material (£12.3 million) audit adjustment was made to the Council's income and expenditure account after the draft accounts were published, subsequently lowered our materiality to £1.34 million. This adjustment related to the fact that South Oxfordshire was collecting income from the other bodies in the 'Five Councils' partnership and then making a single payment to Capita on their behalf. However, the Council was merely acting as an agent in this transaction so the costs were removed the Council's financial statements as per the requirements of the Code of Practice.
Reporting threshold	We agreed with the Joint Audit & Governance Committee that we would report to the Committee all unadjusted audit differences above £79k, but this was also lowered as a result of the above to £67k.

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. We applied a lower threshold for errors.
- Related party transactions, the accounting standard requires us to consider the disclosure from the point of materiality to either side of the transaction we therefore considered this on a case by case basis.
- Members' allowances, we applied a lower threshold for errors.

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

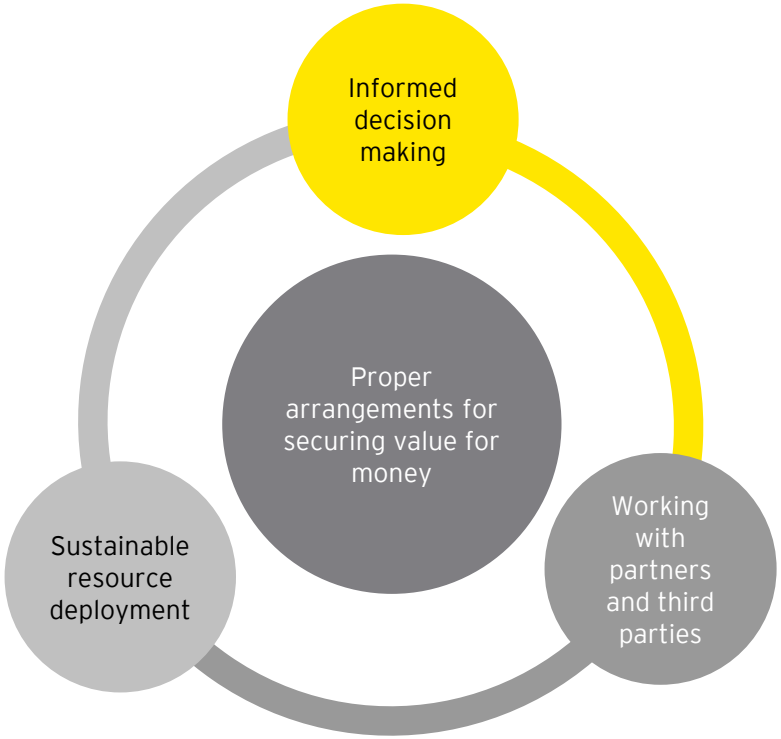
04 Value for Money

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 identified two significant risks in relation to these arrangements. The table below present the findings of our work in response to the risks identified.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Value for Money (cont'd)

Significant Risk	Conclusion
Implementation of the Corporate Services Contracts From the 1 August 2016, the Council began the implementation of the Corporate Services Contracts with Capita (Lot 1) and Vinci (Lot 2) respectively, as part of the five Council Partnership arrangements. These contracts were designed to generate savings of over £50m for the five Councils across their lifetime of nine years but the Councils are now in the process of renegotiating both Lot 1 and Lot 2 due to issues with the way the contracts were constructed and the implications for the practical implementation of them. Given the likely significant changes to the two contracts there is a risk that both the services and financial performance of the Councils would be negatively impacted if renegotiation results in contracts that are difficult to implement or do not deliver the intended benefits.	Our review has focussed on reviewing the governance arrangements over the implementation of the contract and we have concluded on the following: The corporate services contracts remains an ongoing concern for both councils; The amounts invoiced under the Lot 1 Capita Contract are in line with the agreed financial model for core services. However, in light of significant performance issues, such as ongoing payroll processing problems and the delayed implementation of the new general ledger, commercial renegotiations around Lot 1 have been underway throughout 2017/18. As the year has progressed, the councils have also experienced significant issues with the resourcing model and capacity to deliver statutory process such as the annual financial statements. A new inter authority agreement is in place but had yet to be signed at the date of our audit report. The Lot 2 contract to provide estates services has been terminated and the Council is negotiating a financial settlement. The service delivery and associated staff will be brought back in-house. While the original savings figure of £50 million across the five councils was aspirational rather than fully quantified, it is apparent that the level of savings, certainly in the short term, will not be as high as initially planned. However, we noted that if the renegotiation of the Lot 1 contract delivers the intended level of provision, then there is still scope for the councils to find efficiencies from the partnership with Capita. The council continues to monitor the contract performance and the expected governance arrangements are in place, although these are not fully embedded but are strengthening over time. As such, internal and external stakeholders are able to assess the objectives and outcomes of the contract. We have no matters to report.
Senior Management restructure During 2016/17, as part of the transition to the new corporate services contracts, there were significant changes to the joint senior management team at the Council. In 2016/17 our Value for Money (VFM) opinion was qualified due to uncertainties over the process undertaken in connection with the redundancies of two strategic directors. Moving into 2017/18, the council still has a number of Director and Senior Management vacancies, which are currently filled on an interim basis. Until the new structure is permanent and embedded there will be a continued risk to the Council's operational structure and decision-making processes.	Our review has focussed on reviewing the arrangements put in place to manage the restructure and we have concluded on the following: The council acknowledged that the management structure was not fit for purposes and took steps to address this by implementing a new structure from August 2017. The new structure consists of eight Head of Services reporting to the Head of Paid Services. The role of Deputy s151 Officer was also created to provide support to the statutory officer's role. Three of these positions remained interim appointments but these are expected to become permanent as the new structure becomes embedded. Our work also assessed the processes undertaken by the Council after the departure of the previous Chief Executive, both in terms of the internal governance and the legality of the exit packages. We found that the Council had followed due process and obtained the relevant legal advice, which provides us with assurance that the correct arrangements and governance controls were adhered to, Or work on the financial statements identified inconsistencies between the exit packages notes in the accounts and the accounting records but the council has amended these. Moving forward, and with the bulk of the redundancies and re-organisation now complete, the Councils' new structure looks to provide better management support and is better equipped to facilitate service delivery. We have no matters to report.

We therefore issued an unqualified value for money conclusion on 28 September 2018

05 Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

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 2017/18 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.

Other Reporting Issues (cont'd)

Independence

We communicated our assessment of independence in our Audit Results Report to the Joint Audit & Governance Committee on 27 September 2018. 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 adopted a fully substantive approach and have therefore not tested the operation of controls.

Our audit did not identify any controls issues to bring to the attention of the Audit Committee.

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must inform you of any significant findings from the audit, and other matters if they are significant to your oversight of the Authority's financial reporting process. We have previously notified you of one issue which was the delay in receiving audit evidence and the missed statutory audit deadline;

Reduction in staff capacity had a detrimental effect on the timeliness and quality of the evidence provided for audit. As a result of this, the audit was not completed by the statutory deadline of 31 July 2018 because we were unable to gain sufficient evidence within the required timescale to enable the opinion to be issued. We formally notified the Council and Joint Audit and Governance Committee on 17 July 2018 that the statutory deadline would not be met. PSAA were notified of this and the NAO were also made aware that the Whole Government Accounts (WGA) opinion would also be issued late. The audit was completed following a subsequent audit visit in September.

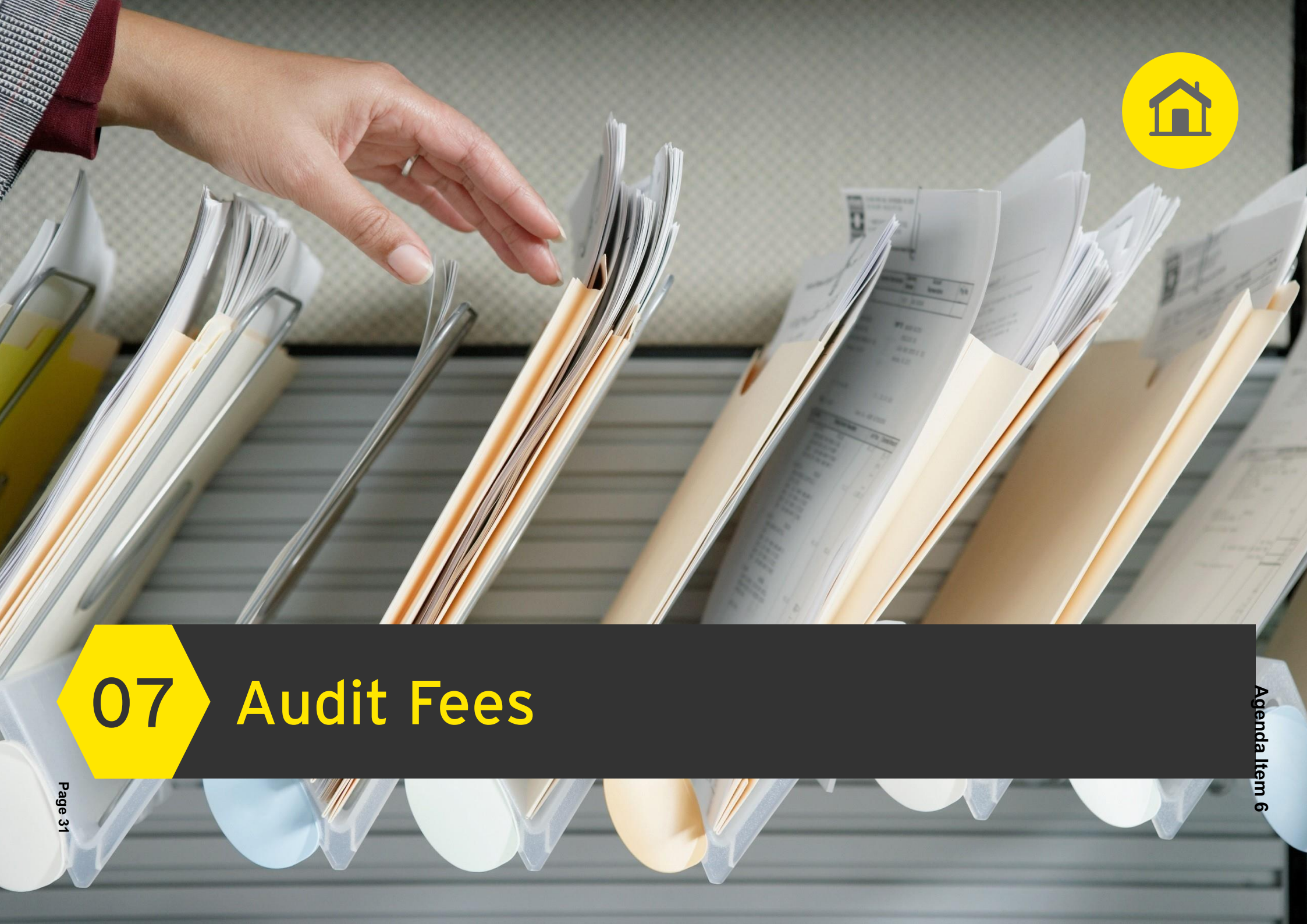
These issues have also had a significant impact on the audit fee which is detailed in section 07 of this letter.

06 Focused on your future

Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial assets. There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.	Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to: ▸ Reclassify existing financial instrument assets ▸ Re-measure and recalculate potential impairments of those assets; and ▸ Prepare additional disclosure notes for material items.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: ▸ Leases; ▸ Financial instruments; ▸ Insurance contracts; and ▸ For local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.	As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited. The standard is far more likely to impact on Local Authority Trading Companies who will have material revenue streams arising from contracts with customers. The Council will need to consider the impact of this on their own group accounts when that trading company is consolidated.



07 Audit Fees

Audit Fees

Our fee for 2017/18 is based on the scale fee set by the PSAA and reflects our reporting in our 27 September 2018 Audit Results Report.

	Final Fee 2017/18	Planned Fee 2017/18	Scale Fee 2017/18	Final Fee 2016/17
	£	£	£	£
Total Audit Fee – Code work	**TBC***	**48,186**	**48,186**	**54,467**
Non-audit work HB grant claims	10,972	10,972	10,972	9,623

*We have proposed and agreed a fee variation of £25,222 in 2017/18 to take account of the additional work required in relation to the delays experienced with the audit plus extra work required as a result of a material amendment to the CIES and the additional VfM risks identified. The delays in the audit caused the cessation of the audit visit in July with an additional 3 week visit in September. The delays were in relation to obtaining sufficient evidence to support the audit opinion. They were across a number of areas but included payroll, PPE, debtors, leases, capital grants, long term debtors, remuneration notes and disclosures more generally, income and expenditure testing, investment property, creditors, contracts, the collection fund and reserves.

This fee is subject to approval by the PSAA.

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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