

Northumberland County Council

Annual Audit Letter for the year ended 31 March 2017

January 2018

Ernst & Young LLP



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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.psa.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.

A hand with white nail polish is writing on a document with a blue pen. In the background, there is a calculator, a laptop, and a white mug. A yellow rectangular box is overlaid on the left side of the image.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Northumberland County Council (“the Council”) following completion of our audit procedures for the year ended 31 March 2017.

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 2017 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, except for the arrangements in place to ensure informed decision making at the Arch Group, which is a wholly owned subsidiary company consolidated into the Council’s group financial statements.

Area of Work	Conclusion
Reports by exception: ▶ Consistency of Annual Governance Statement	The Annual 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.

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	<p>Our Audit Results Report, setting out our findings on the Council’s financial statements, was presented to the Audit Committee on 27 September 2017 setting out our findings at that date and the reasons why we were unable to issue our opinions by the statutory deadline. An updated Audit Results Report setting out our final conclusions was presented to the Audit Committee on 22 November 2017.</p> <p>Our Audit Results Report setting out our findings on the Northumberland Pension Fund financial statements was presented to the Pensions Fund Panel on September 2017 and the Audit Committee on 27 September 2017.</p>
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 the same date as our opinion on the financial statements.

In March 2018, we plan to 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.

Stephen Reid
Partner
For and on behalf of Ernst & Young LLP

Purpose



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 2016/17 Audit Results Report to the 22 November 2017 Audit Committee, representing those charged with governance. The detailed findings arising from our audit of the Northumberland Pension Fund were reported to the 27 September 2017 Audit Committee. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.



Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we presented to the Audit Committee on 29 March 2017 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 2016/17 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 the 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 extent of our review and the nature of our report are specified by the NAO.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (“AGS”). 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.

A blurred office desk with a laptop, glasses of water, and financial documents. The background shows a window with blinds and a potted plant. The foreground features a wooden desk with a laptop, several glasses of water, and various papers, including one with a pie chart and another with a grid.

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 financial statement audit report on 23 November 2017.

Our detailed findings were reported to the 22 November 2017 Audit Committee.

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

Significant Risks	Conclusion
<p>Management override of controls – Council and Pension Fund</p> <p>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.</p> <p>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.</p>	<p>We completed the following work in this area:</p> <ul style="list-style-type: none">• 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.• We evaluated the business rationale for any significant unusual transactions. <p>No significant issues were identified as part of this work.</p>

Significant Risks	Conclusion
<p>Revenue and expenditure recognition – Council only</p> <p>Auditing standards also require us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.</p> <p>We respond to this risk by reviewing and testing material revenue and expenditure streams and cut-off at the year end.</p>	<p>We completed the following work in this area:</p> <ul style="list-style-type: none">• We reviewed and tested revenue and expenditure recognition policies as part of our review of accounting policies.• We reviewed and substantively tested year-end income debtors and accrued income by agreeing to post year-end cash receipts where possible to gain assurance over the validity of income.• We reviewed and substantively tested year end expenditure accruals and provisions by corroborating the assumptions used to third party evidence where possible.• We tested the completeness of expenditure by selecting a sample of invoices posted to the ledger and cash payments made from the bank to check that they have been recorded in the correct period.• We considered the release of provisions and discussed the rationale for this with management to satisfy ourselves that the release was appropriate. <p>No significant issues were identified as part of this work.</p>

Significant Risks	Conclusion
<p>Valuation of unquoted investments and private equity investments – Pension Fund only</p> <p>The Fund's investments include certain complex to value unquoted pooled investment vehicles and private equity funds.</p> <p>Judgements are taken by the Investment Managers to value those investments whose prices are not publically available. Any error in judgement could result in a material valuation error. Current market volatility means such judgments can quickly become outdated, especially when there is a significant time period between the latest available audited information and the fund year end. Such variations could have a material impact on the financial statements.</p> <p>We identified the valuation of the Pension Fund's investment in these complex unquoted pooled investment vehicles and private equity funds as a significant risk, as even a small movement in these assumptions could have a material impact on the financial statements.</p>	<p>We completed the following work in this area:</p> <ul style="list-style-type: none">• We documented and walked through the process and design of the controls over the valuation process.• We obtained third party confirmations of the unquoted and private equity investments at 31 March 2017 from the investment manager.• We reviewed the relevant investment manager controls' reports for qualifications or exceptions that may affect the audit risk.• We reviewed the basis of valuation for the unquoted investments and private equity investments and were satisfied that they were in line with the accounting policies.• We performed tests of valuation by obtaining the latest available audited accounts for the private equity investments and agreeing the net asset value per the confirmation received to the audited accounts provided.• Where the audited accounts did not have the same year end as the Pension Fund we performed additional procedures to obtain assurance that the movement to 31 March 2017 is reasonable. <p>No significant issues were identified as part of this work.</p>

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.

Council materiality

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £17,655,780 for the Council and £18,072,640 for the Group (2015/16: £16,968,820 for the Council and £17,291,670 for the Group), which is 2% of gross expenditure reported in the financial statements.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £883,829 (2016: £848,441).</p>

Pension Fund materiality

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £13.1 million (2015/16: £10.6 million), which is 1% of net assets of the fund.</p> <p>We consider net assets to be one of the principal considerations for stakeholders in assessing the financial performance of the Pension Fund.</p>
Reporting threshold	<p>We agreed with the Pensions Committee that we would report to the Committee all audit differences in excess of £0.25 million (2016: £0.25 million).</p>

A close-up, shallow depth-of-field photograph of a stack of coins. The coins are stacked vertically, with the edges of several coins visible. The lighting is warm, highlighting the metallic texture and the ridges on the edges. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Value for Money".

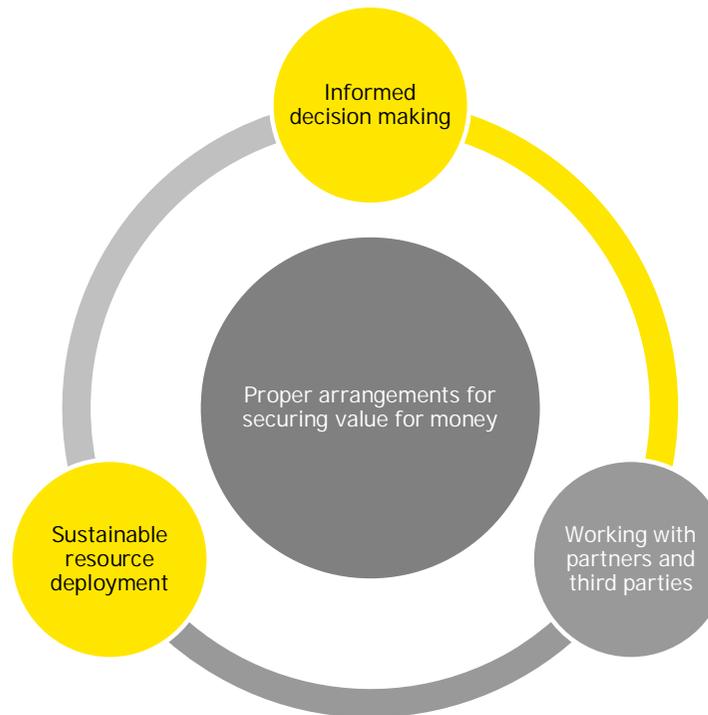
Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in 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 one significant risk in relation to these arrangements. The table below sets out the findings of our work in response to the risk identified.

Significant Risk	Conclusion
<p>The most recent medium financial plan showed that the Council is required to make savings in the region of £36 million over the period 2017/18 – 2019/20. Of the total savings requirement, £30 million is planned for delivery in the final two years of the plan.</p> <p>Given that the Council has been operating in a challenging environment for a number of years now, savings will typically be required to be delivered through more challenging transformational schemes.</p>	<p>We reviewed the assumptions used to develop the medium term financial plan (MTFP) and have no matters to raise over the assumptions used.</p> <p>Our significant risk was attached to the phasing of savings and that £30 million of savings were required in the final two years of the financial plan. Through discussion with management we noted that there are currently no firm plans for achieving this £30 million as all existing savings plans are being reviewed.</p> <p>We considered the financial position of the Council to determine the impact of not having fully developed savings plans and noted that total useable reserves at 31 March 2017 are £137.9 million. This demonstrates that even if the Council was to make no savings in the final two years of the MTFP there would still be useable reserves available greater than £100 million.</p> <p>We also benchmarked the level of reserves held by the Council based on data held by the PSAA for the Council's nearest statistical neighbours and noted that levels of reserves are in the highest 20% of similar authorities.</p> <p>We concluded that we are satisfied that there is no impact on our value for money conclusion arising from this risk.</p>

In August 2017 the Council commissioned an independent review of financial arrangements to ensure that decision making going forward would be based on complete and transparent financial information and that the baseline position was accurate. The review focused on the accuracy and completeness of the base budget, together with the veracity of the underpinning processes and systems and the Council's longer term financial plans. The overall conclusion from the review was that, whilst areas for improvement to the process of preparing the budget were identified, there were no indications of significant errors or omissions and that there was an adequate base to take forward future financial plans. We are satisfied that there were no findings from this review that are material to our value for money conclusion.

Following presentation of our Audit Plan in March 2017 we were made aware of allegations of impropriety at the Arch Group, a group of wholly owned subsidiary companies. The Council's internal auditors were commissioned to undertake a review of arrangements. We requested a copy of the draft report in relation to the review, together with details of the emergent findings in early August. In October 2017 management provided access to the information and met with us to discuss the findings. We have concluded that, as the review identified that the principles and values of sound governance were not always in place for some decisions taken during 2016/17, a modification to our value for money opinion was required and a qualified conclusion was issued on 23 November 2017.



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 matters 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 2016/17 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 22 November 2017. In our professional judgement, the firm is independent and the objectivity of the audit engagement associate partner and audit staff has not been compromised within the meaning of 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 did not identify any issues to report to you that have not already been identified by management.

A close-up photograph of a person's face as they look through a pair of black binoculars. The person's eyes are focused on the lenses, and their hands are visible holding the device. The background is a soft, out-of-focus white. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Focused on your future".

Focused on your
future

Focused on your future

Area	Issue	Impact
Early Close	The main area for change in the Audit and Accounts Regulations 2015 is the requirement for councils to approve and publish their financial statements by 31 May and 31 July respectively (currently 30 June and 30 September).	<p>It is imperative that there is early dialogue between the Council and the audit team to agree a planned approach to support the Council in achieving the challenges of early close. This dialogue will result in new ways of working, which could include:</p> <ul style="list-style-type: none"> • Increased focus on data quality to minimise reworking and adjustments at year-end. • A clear understanding of what information will help your audit team complete their year-end audit visit, for example a detailed client assistant schedule. • Consideration of what areas of the final accounts process can be delivered early and can be audited before the year-end, for example property valuations, material provisions and accruals, group boundary assessments and accounting policies. • Review of the Council's accounting policies to assist the early close process, for example a de-minimis accruals policy. • Consideration of 'soft closes' at key points during the year, for example month 6 and 9, to enable interim audits prior to year-end therefore spreading the work through the year and reducing the workload at year-end.

Appendix A

Audit Fees



Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our Audit Results Report.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work (Council)*	TBC	TBC	190,596	195,596
Total Audit Fee – Code work (Pension Fund)	22,516	22,516	22,516	22,516
Total Audit Fee – Certification of Housing Benefit Subsidy Claim	9,900	9,900	9,900	9,341
Non-audit work – Certification of other claims**	TBC	15,000	-	16,600
Non-audit work – Tax advice	40,350	-	-	40,350

* We have requested a scale fee variation for the additional work undertaken in respect of the Value for Money risks in 2016/17 and we will update the Audit Committee with the final fee once this has been confirmed

** We have completed our certification work on the Morpeth Bypass claim and the Teachers Pension Return. Our work on the pooling of housing capital receipts return is due to be completed by 31 January 2018; however we do not expect any matters to arise that will result in a variation to the agreed fee.

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ED None

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