

Northumberland County Council Audit Results Report

Year ended 31 March 2019

FINAL DRAFT – November 2019

Private and Confidential

October 2019

Dear Audit Committee Members

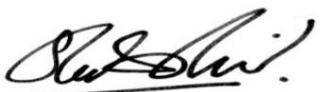
We attach our Audit Results Report for the forthcoming meeting of the Audit Committee. This report summarises the status of our audit of Northumberland County Council ("the Council") for 2018/19.

We have substantially completed our audit work on the financial statements of the Council for the year ended 31 March 2019.

We confirm that [we expect to issue an unqualified audit opinion on the financial statements in the form set out in Section 3]. We do, however, have matters to report on your arrangements to secure economy, efficiency and effectiveness in your use of resources and expect to issue an adverse opinion in respect of the Council's arrangements for informed decision making.

This report is intended solely for the use of the Audit Committee, other members of the Council, and senior management. It should not be used for any other purpose or given to any other party without obtaining our written consent.

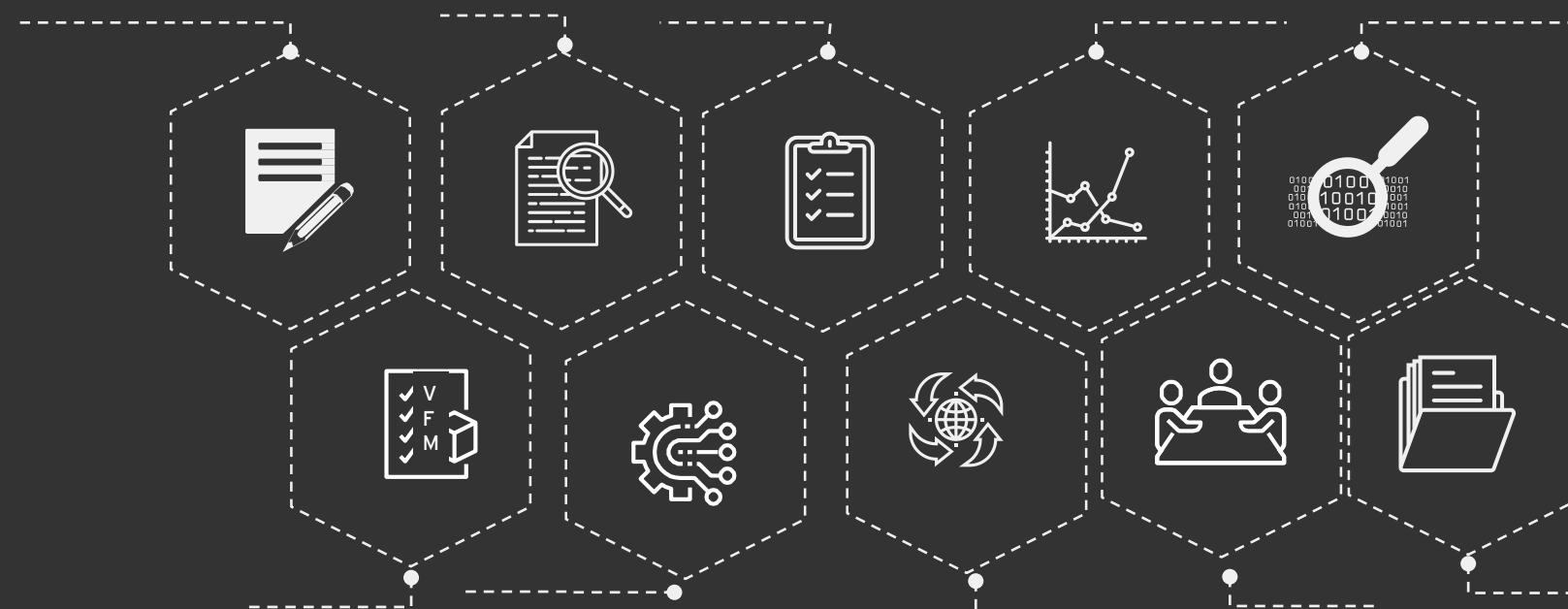
Yours faithfully



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

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As part of the Auditor Engagement process, we have agreed with you the respective responsibilities of auditors and audited bodies. Copies of the Engagement Contract and Terms and Conditions of our appointment are available from the Chief Executive or via the bodies minutes on their website. The Terms and Conditions of our appointment contained within the Engagement Contract 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 Audit Results Report is prepared in the context of the Terms and Conditions of Engagement. 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.

The background of the slide shows a close-up, slightly blurred image of a person's hands interacting with a white tablet computer. The tablet screen displays some text and icons, including the number '25'. The hands are positioned as if the person is typing or swiping on the device.

01 Executive Summary

Executive Summary

Scope update

In our Audit Planning Report presented at the 27 March 2019 Audit Committee meeting, we provided you with an overview of our audit scope and approach for the audit of the financial statements.

We updated our planning materiality assessment using the draft consolidated results and have also reconsidered our risk assessment. Based on our materiality measure of gross expenditure on provision of services, we updated our overall Group materiality assessment to £17.8 million (Audit Planning Report £16 million). This results in updated performance materiality, at 75% of overall materiality, of £13.4 million, and an updated threshold for reporting misstatements of £890,000.

Status of the audit

We have substantially completed our audit of the Council's financial statements for the year ended 31 March 2019 and have performed the procedures outlined in our Audit Planning Report. At the time of writing this report, the following areas of work are still outstanding:

- ▶ Receipt of formal reporting on the Advance Northumberland Limited audit from the component audit team;
- ▶ Receipt and review of final financial statements;
- ▶ Whole of Government Accounts;
- ▶ Final engagement senior manager and partner review of the audit file; and
- ▶ Update of subsequent events and audit completion procedures.

Audit differences

We have one unadjusted difference to the Group financial statements to reflect the fact that only intra-group profit was eliminated from the Advance financial statements submitted for consolidation, rather than the gross intra-group income and expenditure transactions.

The financial statements were amended to take account of:

- ▶ the impact of the McCloud / Sergeant judgements regarding unlawful age discrimination for members of the Local Government Pension Scheme;
- ▶ adjustments to the basis of valuation of some land and buildings; and
- ▶ amendments to the valuation of the investment in Newcastle International Airport Limited.

Further detail on these matters is included in Section 2 of this report.



Executive Summary

Areas of audit focus

Our Audit Planning Report identified key areas of focus for our audit of the Council's financial statements. This report sets out our observations and conclusions, including our views on areas which might be conservative, and where there is potential risk and exposure. We summarise our consideration of these matters, and any others identified, in Section 2 of this report. We ask you to review these and any other matters in this report to ensure:

- ▶ there are no other considerations or matters that could have an impact on these issues;
- ▶ you agree with the resolution of any issues; and
- ▶ there are no other significant issues to be considered.

There are no matters, apart from those reported by management or disclosed in this report, which we believe should be brought to the attention of the Audit Committee.

Control observations

We have adopted a fully substantive approach, so have not tested the operation of controls; however during the course of our audit work we identified the following opportunities for the enhancement of internal control:

- ▶ The fixed asset working papers are complex and require a large amount of manual manipulation by management. We recognise that management have undertaken a significant amount of work during the course of 2018/19 to simplify the working papers; however due to the sizeable nature of the asset base held by the Council there still remains a higher level of risk of error whilst a spreadsheet based approach remains in place. We recommend that management consider whether they are able to accept the level of risk inherent in the current approach or whether they may want to look to introduce a more system-based approach to managing the asset base.
- ▶ The Council upgraded the general ledger to the Oracle Cloud in November 2018 and we noted that since the new system had been implemented, monthly key control account reconciliations were not being performed as management were unable to access the reports that they needed. We recommend that this is prioritised so that the full schedule of reconciliations is in place for 2019/20.

We have also made a number of observations in the additional procedures and value for money sections of the report. We recommend that the Audit Committee determines and agrees how they would like to take these observations forward.



Executive Summary

Additional procedures

In our draft Audit Results Report presented to the Audit Committee on 24 July 2019, we highlighted that we were unable to issue our opinion on either the financial statements or our Value for Money (VfM) conclusion, as we had received correspondence in relation to allegations under a whistleblowing disclosure.

We notified management of the correspondence, which we considered obliged us to investigate as the allegations related to senior management and others that have significant roles in internal control. Additionally, there was the potential for there to be more than an inconsequential impact both on the financial statement opinion and/or our value for money conclusion.

As part of our work, we made observations regarding management culture, the independence of internal audit and the role of the finance function. Further details of our findings and recommendations can be found in the 'Additional Procedures' section of this report.

Value for Money

In accordance with our responsibilities as external auditor, we consider the Council's arrangements to take informed decisions; deploy resources in a sustainable manner; and work with partners and other third parties. In our Audit Planning Report, we identified a significant risk in relation to taking informed decisions, with a specific focus on:

- ▶ the transfer of trade and activities from the Arch Group to Advance Northumberland; and
- ▶ follow up of the modified conclusion in place for the prior year in relation to the governance and controls at the Advance Group.

We considered our findings and observations from our additional procedures and considered these, together with our work performed in relation to the significant risks identified at the planning stage, against Auditor Guidance Note 03 issued by the National Audit Office. We intend to issue an adverse opinion in relation to the Council's arrangements for making informed decisions. Further details on this are included in the Value for Money section of this report.

Other reporting issues

We have reviewed the information presented in the Annual Governance Statement for consistency with our knowledge of the Council. [In our view, the Annual Governance Statement requires to be updated to reflect the material findings and observations identified as part of our additional procedures conducted in relation to allegations received by us under a whistleblowing disclosure. We will discuss this with management and update the Audit Committee at the forthcoming meeting].

We are required to perform procedures required by the National Audit Office on the Whole of Government Accounts submission. These procedures are required to be performed on the final version of the financial statements and therefore we are unable to complete this work until we have received the final version of the financial statements.



Executive Summary

Other reporting issues

On 4 October 2019 we received correspondence from the Chief Executive advising of the intention to propose the removal of EY as Local Auditor of the Council and associated entities at a full Council meeting to be held on 6 November. On 25 October, further correspondence from the Chief Executive advised that she was arranging to have the proposed removal of us as Local Auditor withdrawn as an item for consideration at the 6 November Council meeting, as there had been insufficient time to finalise the required report to meet the Council's established reporting and clearance processes. At the time of writing, we are not aware that a revised timetable has been put in place.

We have no other matters to raise at the time of writing this report.

Independence

Please refer to Section 9 for our update on independence.

We also provide an updated assessment of the additional time incurred, and fee impact, for undertaking and completing the audit work to allow us to conclude on the various matters in accordance with our professional responsibilities.

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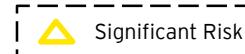
Areas of Audit Focus



Areas of Audit Focus

Significant risk

Risk of fraud in revenue and expenditure recognition



What is the risk?

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.

The Council has achieved a surplus outturn position for the last number of years and was forecasting a small underspend against budget for 2018/19. As the financial position of the Council is expected to become more challenging in future years, we assessed our risk as relating to the understatement of revenue and overstatement of expenditure.

What judgements are we focused on?

The main judgements we focussed on were:

- ▶ consideration of whether deferrals of income are appropriate;
- ▶ whether expenditure estimates that require a level of judgement such as provisions and accruals are fairly stated; and
- ▶ Checking that income and expenditure recognised around the year-end is recorded in the correct period.

What did we do?

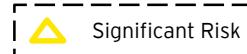
- ▶ We reviewed and tested revenue and expenditure recognition policies;
- ▶ We reviewed, discussed with management, and tested accounting estimates for deferral of revenue or expenditure recognition for evidence of bias; and
- ▶ We reviewed a sample of transactions recorded in the ledger and payments made from the bank account post year-end and confirmed that the associated income and expenditure has been recorded in the correct period.

What are our conclusions?

We have not identified any indicators of fraud in revenue or expenditure recognition during the course of our audit work.

Significant risk

Misstatements due to fraud or error



What is the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA 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.

What judgements are we focused on?

At the time of our audit planning, we did not identify any specific risks of material misstatement due to fraud or error, other than those already addressed through our consideration of the risk of fraud in revenue and expenditure recognition.

Therefore, our work in this area focussed on reviewing manual journal entries, through the use of our data analytics tools, as this is the way in which management would most easily be able to manipulate accounting records.

What are our conclusions?

We did not identify any other transactions during our audit which appeared unusual or outside of the Council's normal course of business.

We have not identified any evidence of management bias in our review of estimates.

We did not identify any exceptions as part of our testing of manual journals.

Areas of Audit Focus

Significant risk

Valuation of land and buildings

What is the risk?

The fair value of property, plant and equipment ("PPE") and investment properties ("IP") represents a significant balance in the Group's financial statements and is subject to valuation changes, impairment reviews and depreciation charges.

Management of the Council and the Advance Northumberland are required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

What did we do?

- ▶ We have considered the work performed by the Group's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.
- ▶ We have sample tested key asset information used by the valuation team in performing their valuation (e.g. floor plans to support valuations based on price per square metre).
- ▶ We have considered the annual cycle of valuations to ensure that assets have been valued within a five year rolling programme as required by the CIPFA Code.
- ▶ We have considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer.
- ▶ We have reviewed assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated.
- ▶ We have considered changes to useful economic lives as a result of the most recent valuation.
- ▶ We have tested accounting entries to ensure they have been correctly processed in the financial statements.

What are our conclusions?

Our work on the valuation of PPE on Council dwellings found that valuations were within an acceptable range and we have no matters to report on this matter.

Our work on the valuation of other land and buildings identified that the Council's valuation experts had excluded allowances for site works, fees and contingencies in some of their calculations resulting in an understatement to the valuation of £7 million. This has been amended in the final version of the financial statements.

We have discussed the status of the valuations work at Advance Northumberland with the component audit team and note that all valuations within our sample fell within an acceptable range.

We have no other findings to raise as part of this work.



Areas of Audit Focus

We identified other areas of the audit, that were not classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures.

What was the risk/area of focus?	What were our conclusions?
<p>Pension Liability Valuation</p> <p>The Council's local government pension scheme liability is a material estimate on the Council's balance sheet. At 31 March 2018 the total value of the liability was £708 million.</p> <p>Calculation of the liability involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf.</p> <p>A small movement in the assumptions can have a material impact on the value of the liability and auditing standards require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>The Local Government Pension Scheme (England and Wales) (LGPS) introduced a new career average earnings benefit structure with effect from 1 April 2014 ('the 2014 scheme'). For members who were 10 years or less from Normal Retirement Age on 1 April 2012 (i.e. aged 55 or above), an underpin was provided based on the existing final salary scheme ('the 2008 scheme'). In December 2018, the Court of Appeal found that similar transitional provisions in the pension schemes for firefighters (Sargeant Judgement) and the judiciary (McCloud Judgement) resulted in unlawful age discrimination and given their similarity are also deemed to be applicable to the LGPS.</p> <p>The Government was seeking to appeal against this decision, however on 27 June 2019 they were denied the right to appeal. Due to the original judgements being in place before 31 March 2019, all scheduled and admitted bodies of the LGPS were asked to consider the impact of the McCloud judgement on their pension valuations as at 31 March 2019.</p> <p>Since 27 June 2019, the Council has requested that the actuary, Aon Hewitt, re-run their year end pension valuation, taking into account the McCloud judgement. This revised report also takes into account updated asset values for the Council at 31 March (asset values are usually based on an estimated position) and Guaranteed Minimum Pension requirements.</p>
<p>Changes to group structure</p> <p>The trade and activities of the Arch Group were transferred to Advance Northumberland, a new wholly owned subsidiary company of the Council in November 2018. The accounting for the transfer in the Group's subsidiary entities is complex, which will be significant for the Council's group financial statements.</p>	<p>The Advance Northumberland component audit team have reviewed the accounting for the change in Group structure and concurred with the judgement of management of Advance Northumberland that 'merger accounting' was the most appropriate basis for the transaction. This means that Advance Northumberland financial statements recognise the trade and activity as if it was in place for the full year.</p> <p>We have yet to receive the final reporting from our component audit team; however our understanding is that there are some adjustments required to the reserves in the Advance Northumberland statutory financial statements to reflect the appropriate accounting treatment; however these should be eliminated at Group level.</p> <p>We have also identified one unadjusted difference of £11.065 million in the Group financial statements as a result of only intra-group profit being eliminated in the Advance financial statements provided for consolidation, rather than gross intra-group income and expenditure.</p> <p>There were no other findings arising from the accounting for these changes in Group structure.</p>

Areas of Audit Focus

We identified other areas of the audit, that were not classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements.

What was the risk/area of focus?	What were our conclusions?
<p>IFRS 9 financial instruments</p> <p>This new accounting standard is applicable for local authority financial statements from the 2018/19 financial year and changes:</p> <ul style="list-style-type: none">▶ How financial assets are classified and measured;▶ How the impairment of financial assets are calculated; and▶ The disclosure requirements for financial assets. <p>There are transitional arrangements within the standard; and the 2018/19 CIPFA Code of Practice on Local Authority accounting provides guidance on the application of IFRS 9 which required to be applied</p>	<p>We reviewed and challenged the approach taken by management in relation to key judgements, such as expected credit loss allowances for balances with the subsidiary companies and other bodies and concurred with their conclusion.</p> <p>We note that a valuation of the shares in Newcastle International Airport Limited (NIAL) was commissioned as a result of the introduction of IFRS 9. We engaged our EY infrastructure valuations team to review the valuation and, as a consequence, an adjustment was made to the valuation of the Council's shares so that a £0.1 million surplus on valuation was recognised in the financial statements rather than the £6.3 million deficit on valuation reflected in the draft financial statements.</p> <p>We also identified some minor improvements to disclosures through our completion of the CIPFA disclosure checklist that we have highlighted to management for updating in the final version of the financial statements.</p>
<p>IFRS 15 Revenue from contracts with customers</p> <p>This new accounting standard is applicable for local authority financial statements from the 2018/19 financial year.</p> <p>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.</p> <p>The 2018/19 CIPFA Code of Practice on Local Authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of revenue and how they should be recognised.</p>	<p>We obtained the IFRS 15 impact assessment prepared by management and concurred with their view that the new standard was unlikely to have a material impact on the financial statements.</p> <p>We completed the CIPFA disclosure checklist and did not have any material matters to report.</p>



Areas of Audit Focus

We identified other areas of the audit, that were not classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements.

What was the risk/area of focus?	What were our conclusions?
<p>General Ledger Upgrade</p> <p>The Council upgraded the Oracle General Ledger system to the Oracle Cloud in December 2018. We were therefore required to perform a transfer of data audit to ensure that the financial statements are based on a complete set of transactions for the year.</p>	<p>We liaised with our IT audit colleagues to develop a work programme and reviewed and tested the reconciliations performed for the transfer of data from the old to the new systems.</p> <p>We did not identify any findings that suggest the financial statements are based on an incomplete set of data.</p>



03 Audit Report





Audit Report

Draft audit report

Our opinion on the financial statements

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHUMBERLAND COUNTY COUNCIL

Opinion

We have audited the financial statements and the firefighters' pension fund financial statements of Northumberland County Council for the year ended 31 March 2019 under the Local Audit and Accountability Act 2014. The financial statements comprise the:

- ▶ Authority and Group Movement in Reserves Statement,
- ▶ Authority and Group Comprehensive Income and Expenditure Statement,
- ▶ Authority and Group Balance Sheet,
- ▶ Authority and Group Cash Flow Statement,
- ▶ Related notes to the financial statements 1 to 46,
- ▶ Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the related notes 1 to 10,
- ▶ Collection Fund and the related notes 1 to 2,
- ▶ and include the firefighters' pension fund financial statements comprising the Fund Account, the Net Assets Statement and the related notes 1 to 4.

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

In our opinion the financial statements:

- ▶ give a true and fair view of the financial position of Northumberland County Council and Group as at 31 March 2019 and of its expenditure and income for the year then ended; and
- ▶ have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard and the Comptroller and Auditor General's (C&AG) AGN01, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- ▶ the Section 151 Officer's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- ▶ the Section 151 Officer has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.



Audit Report

Draft audit report

Our opinion on the financial statements

Other information

The other information comprises the information included in the Statement of Accounts, other than the financial statements and our auditor's report thereon. The Section 151 Officer is responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinion on other matters prescribed by the Local Audit and Accountability Act 2014

Arrangements to secure economy, efficiency and effectiveness in the use of resources

Basis of Adverse Conclusion

Turnover of s.151 Officers

Since May 2017, the Council has had three Section 151 Officers in post and is currently recruiting for a permanent appointment. The high level of turnover in the post heightens the risk that the Council is unable to demonstrate how they are able to secure appropriate administration over their financial affairs as there is a loss of corporate knowledge and senior local government experience, when it comes to developing and approving budgets set.

Maintenance of a sound system of internal control

We identified potential threats to the independence of the Council's internal audit function including the Chief Internal Auditor taking on roles which could be perceived to be management functions and the employment of a close relative of a senior manager by the shared Internal Audit Service who worked on Council audits. The safeguards in the Public Sector Internal Audit Standards to prevent conflicts of interest in these areas had not been applied. We also observed that management did not recognise these threats to the perception of the independence and believed that, as the Chief Internal Auditor is employed by another body, independence was inbuilt into the arrangements.

We have observed that there have been instances where the name of the Section 151 Officer has been added to public reports without their specific sign-off. This is a weakness in the report approval process and it could be misleading to the users of the report and other stakeholders and creates a risk that decisions are made on incomplete or inaccurate financial information.



Audit Report

Draft audit report

Our opinion on the financial statements

Management and cultural challenges

The Council operates within a highly politically charged environment and we have observed a growing tension between the main political parties over the last few years. Management has commented that the politics of the Council can make it difficult to carry out their 'day job' and it is clear that the historical issues are still at the forefront of management's mind. The above factors create the potential to seriously impact on the Council's governance arrangements and there is a risk that improvements to management culture and governance are not being progressed as quickly as required.

Management of wholly owned subsidiary companies

Management commissioned a review of the wholly owned group of subsidiary companies in June 2017 in response to allegations of impropriety concerning transactions entered into during the financial year 2016/17. The review identified that there were some significant weaknesses in proper arrangements for acting in the public interest and that there was evidence that the principles and values of sound governance were not appropriately applied for decisions taken.

During 2017/18 and 2018/19 work has been undertaken by management to strengthen the governance arrangements in relation to the oversight of the subsidiary companies; however the new arrangements were not fully embedded for the whole year.

Our opinion was also qualified in this respect of this matter for the years ended 31 March 2017 and 31 March 2018.

The above matters are evidence of weaknesses in proper arrangements for taking informed decisions and the Council is not demonstrating and applying the principles and values of sound governance.

Adverse conclusion

In our opinion, based on the work undertaken in the course of the audit, having regard to the guidance issued by the Comptroller and Auditor General (C&AG) in November 2017, we are not satisfied that, in all significant respects, Northumberland County Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

Matters on which we report by exception

We report to you if:

- ▶ in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Council;
- ▶ we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- ▶ we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- ▶ we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- ▶ we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- ▶ we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects



Audit Report

Draft audit report

Our opinion on the financial statements

Responsibility of the Section 151 Officer

As explained more fully in the Statement of the Section 151 Officer's Responsibilities set out on page 25, the Section 151 Officer is responsible for the preparation of the Statement of Accounts, which includes the Authority financial statements and the firefighters pension fund financial statements in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19, and for being satisfied that they give a true and fair view.

In preparing the financial statements, the Section 151 Officer is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Authority either intends to cease operations, or have no realistic alternative but to do so.

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General (C&AG) in November 2017, as to whether the Northumberland Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Northumberland County Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.



Audit Report

Draft audit report

Our opinion on the financial statements

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, Northumberland County Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office (NAO) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Certificate

We certify that we have completed the audit of the accounts of Northumberland County Council in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice issued by the National Audit Office.

Use of our report

This report is made solely to the members of Northumberland County Council, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Northumberland County Council and Northumberland County Council's members as a body, for our audit work, for this report, or for the opinions we have formed.

Stephen Reid (Key Audit Partner)
Ernst & Young LLP (Local Auditor)
Newcastle upon Tyne

The maintenance and integrity of the Northumberland County Council web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions



04 Audit Differences





Audit Differences

In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and the disclosures and amounts actually recorded. These differences are classified as “known” or “judgemental”. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

Summary of adjusted differences

Pension Valuation at 31 March 2019: Due to the Government's appeal against the McCloud Judgement being refused on 27 June 2019, all LGPS scheduled and admitted bodies have been asked to consider the impact of the judgement on their pension valuations as at 31 March 2019. The Council has obtained an updated pension valuation, which changed the valuation included in the Council's financial statements by £20 million.

Valuation of land and buildings: Our work on the valuation of other land and buildings identified that the Council's valuation experts had excluded allowances for site works, fees and contingencies in some of their calculations resulting in an understatement to the valuation of £7 million. Management has updated the financial statements to make this correction.

Valuation of shares in Newcastle International Airport Limited: We engaged our EY infrastructure valuations team to review the valuation and, as a consequence, an adjustment was made to the valuation of the Council's shares so that a £0.1 million surplus on valuation was recognised in the financial statements rather than the £6.3 million deficit on valuation reflected in the draft financial statements.

Summary of unadjusted differences

Group Comprehensive Income and Expenditure Statement: The Advance Northumberland financial statements, presented for consolidation into the Group, only eliminated intra-group profit rather than the gross intra-group income and expenditure. As a consequence, income and expenditure in the Council's Group Comprehensive Income and Expenditure statement is overstated by £11.065 million. Management do not wish to adjust for this difference as they do not believe that it has a material impact on the Group financial statements. We will seek formal written confirmation of this in the Management Representation Letter provided to us upon conclusion of the audit.



05

Additional procedures undertaken



Findings from our additional procedures following allegations received

In our Audit Results Report presented to the Audit Committee on 24 July 2019, we highlighted that we were unable to issue our opinions on either the financial statements or our Value for Money (VfM) conclusion as a result of allegations made to us. In accordance with our responsibilities, we were obliged to perform additional procedures. On 17 March 2019 we received correspondence containing allegations, following which we reviewed and considered the correspondence containing the allegations, responded to those making the allegations, held a meeting with those making the allegations, reviewed a large amount of paperwork and documents provided by them and undertook extensive internal consultations, including in respect of the development of the work plan to address the allegations.

On 25 June 2019 we notified management that these allegations would be treated as a 'protected disclosure', as the allegations related to senior management and others that have significant roles in internal control and may therefore, cause a more than inconsequential impact both on the financial statement opinion and / or our value for money conclusion. On 22 July 2019, we received confirmation from management that they were content for us to undertake our work in relation to the allegations and that they were collating the relevant documentation that we had initially requested. Following further correspondence, on 2 August 2019, management provided consent for us to proceed with our additional procedures. The final pieces of evidence from management were received on 10 September 2019.

Due to the nature of the allegations, and in line with EY audit guidance that we follow upon receipt of such allegations, we considered it appropriate to ask members of the EY Forensic and Integrity Services team to undertake the additional procedures to help determine the impact of the allegations on our audit work, the results of which we set out in this section. The work consisted primarily of documentation review and interviews. The work, and consequently our findings were limited, in our view, by the Council's insistence that we allow Council representatives and note takers to attend the interviews (separately and in addition to any individuals that interviewees requested to accompany them). In our experience, the presence of additional people in interviews can limit the free flow of information. We had also agreed a process with management for communication to ensure that confidentiality was maintained. We noted that some of the later evidence requested had been managed by officers outside of this agreed process.

The key allegations raised with us fell into the following broad categories: independence and integrity of senior management, including allegations of bullying; independence of the Council's Internal Audit function; use of funds for political purposes; and other governance concerns. We have set out our findings from our work below.

From the additional procedures undertaken we did not find evidence to support the allegations regarding a lack of independence and integrity of senior management, bullying, or the inappropriate use of funds for political purposes. However, in our view, there are management and cultural challenges facing the Council that need to be urgently addressed. It was noted during our work that initiatives such as the staff survey are already being used to help management. Our concerns in this area are heightened by the high turnover of section 151 officers over the past year. We also note that the Council operates within a highly politically charged environment and we have observed a growing tension between the main political parties over the last few years. Management has commented that the politics of the Council can make it difficult to carry out their 'day job'. It is clear that the historical issues are still at the forefront of management's mind and this is supported by the fact that, in our interviews management incorrectly assumed that our work was focussed on issues from the past, some of which had already been considered in our prior years work and concluded upon at that time, rather than focussed on the current management and operating environment.

In our view, the above factors create the potential to seriously impact on the Council's governance arrangements and there is a risk that improvements to management culture and governance are not being progressed as quickly as required. We therefore recommend that management should take positive steps to reset culture to allow for the governance and operational improvements to proceed. The other detailed findings from our work are set out in the tables over the page.



Findings from our additional procedures following allegations received

Finding	Evidence obtained	Recommendations	Impact on Audit
<p>Independence of the Internal Audit function</p> <p>The Internal Audit function of any public sector organisation must follow the requirements of Public Sector Internal Audit Standards ('PSIAS'). An important element of these standards is section 1100 '<i>Independence and Objectivity</i>'.</p> <p>Not only must the Internal Audit function be independent, it also must be perceived as such.</p> <p>We identified the following areas where the independence of the Council's Internal Audit service could be perceived to be compromised:</p> <ol style="list-style-type: none">1) The Chief Internal Auditor is listed as a member of the Transformation Board in the Transformation Board Terms of Reference which were agreed in June 2019, and was identified as a corporate sponsor for one work stream in the Transformation Plan update presented to informal Cabinet. This could be perceived to be a management function and cause a conflict of interest should any internal review of the implementation of the transformation plan be required;2) Since September 2018, the Chief Internal Auditor has regularly attended the Council's executive team meetings where operational matters are discussed and agreed upon. This could be perceived to be a conflict of interest as the Chief Internal Auditor will be aware of the rationale for key operating decisions which could impair objectivity;3) An immediate family member of a senior officer of the Council was employed by the Internal Audit service between March and September 2019 and worked on Council Internal Audit work. We have been informed that declarations were made to the Leader, Deputy Leader and Lead Cabinet member for governance; however we would have expected declarations to be made to the Audit Committee as those charged with governance of the Council. <p>It is also a concern to us that, in our interviews, management did not recognise these threats to the perception of the independence and believed that, as the Chief Internal Auditor is employed by another body, independence was inbuilt into the arrangement.</p>	<p>Public Sector Internal Audit Standards (updated March 2017)</p> <p>Northumberland County Council Transformation Board Terms of Reference</p> <p>Informal Cabinet Report on the Strategic Transformation Plan Update</p> <p>Minutes of Northumberland County Council Executive Team meetings</p> <p>Interviews held.</p>	<p>Section 1112 '<i>Chief Audit Executive Roles Beyond Internal Auditing</i>' of the PSIAS sets out requirements where the Chief Internal Auditor takes on roles outside of internal audit. Specifically, there is a requirement that any roles outside of internal audit, together with the perceived threats of independence, should be highlighted to the Board and the safeguards in place should be approved.</p> <p>We recommend that a paper is produced for Audit Committee setting out the additional roles of the Chief Internal Auditor alongside the perceived threats to independence and the safeguards that have been put in place. This should be periodically reviewed and approved by the Audit Committee (who meet the definition of the Board set out in the PSIAS).</p> <p>We understand that the relative of the senior manager is no longer employed by the Internal Audit Service; however we recommend that a process is documented and approved so it can be followed should a similar circumstance arise in the future.</p>	<p>We have considered the impact of these potential threats to the independence of the Internal Audit function as part of our overall Value for Money conclusion.</p>



Findings from our additional procedures following allegations received

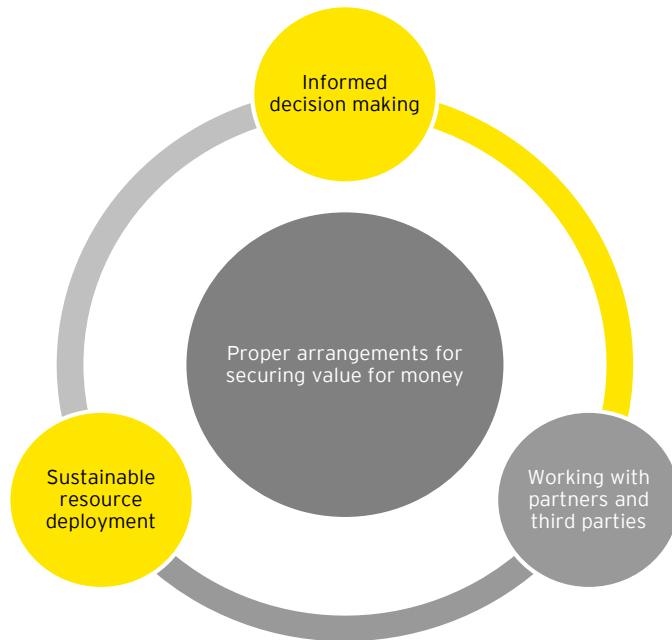
Finding	Evidence obtained	Recommendations	Impact on Audit
<p>Role of the finance function</p> <p>The Local Government Act 1972 requires that every local authority should "<i>make arrangements for the administration of their financial affairs and shall secure that one of their officers has responsibility or administration of those affairs</i>". This role is commonly known as the Section 151 officer.</p> <p>Since May 2017, the Council has had three Section 151 Officers in post and is currently recruiting for a permanent appointment (we understand that the appointment of a new Section 151 Officer is in the final stages of the process). The high level and sudden nature of turnover in the post heightens the risk that the Council is unable to demonstrate how they are able to secure appropriate administration over their financial affairs as there is a loss of corporate knowledge and senior local government experience, when it comes to developing and approving budgets set.</p> <p>We are also aware that there have been instances where the name of the Section 151 Officer has been added to public reports without their specific sign-off. Although there may not have been a deliberate intention to exclude the relevant finance input, we do view this as a weakness in the report approval process and it could be misleading to the users of the report and other stakeholders and creates a risk that decisions are made on incomplete or inaccurate financial information.</p> <p>During the course of our work, we have been informed that Section 151 Officers have been told that they should not meet with the External Auditor without the Chief Internal Auditor present. This is contrary to the guidance in the CIPFA publication "<i>The role of the Chief Finance Officer in Local Government</i>" which states that "<i>As holders of the 'red card', the CFO must exercise a professional responsibility to intervene in spending plans in order to maintain the balance of resources so that the authority remains in sound financial health. To ensure that the necessary corrective action is implemented, the CFO must have direct access to the chief executive, other leadership team members, the audit committee and also to external audit.</i>"</p>	<p>Local Government Act 1972</p> <p>CIPFA: The role of the Chief Finance Officer in Local Government</p> <p>Executive team structure</p> <p>Interviews held.</p>	<p>We recommend that the Council looks to make an appointment with significant local government finance experience to best support the current executive team and an exercise is performed to assess whether there are any other gaps in sector knowledge or experience where it might be beneficial to look for additional support.</p> <p>Upon appointment of the new Section 151 Officer, we recommend that the process for signing off reports and communication with all stakeholders is reviewed to ensure that the Section 151 Officer is able to meet all of the requirements of their role, including "<i>Ensuring that financial and performance information presented to members of the public, the community and the media covering resources, financial strategy, service plans, targets and performance is accurate, clear, relevant, robust and objective</i>" in line with principle 3 of '<i>The role of the Chief Finance Officer in Local Government</i>'.</p>	<p>We have considered the impact of these findings on the role of the finance function on our overall VfM conclusion.</p>



06

Value for Money Risks





Background

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.

For 2018/19 this is based on the following overall evaluation 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"

Proper arrangements are defined by statutory guidance issued by the National Audit Office (NAO). They comprise the Council's arrangements to:

- ▶ take informed decisions;
- ▶ deploy resources in a sustainable manner; and
- ▶ work with partners and other third parties.

In considering your proper arrangements, we draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents, such as your Annual Governance Statement.

Overall conclusion

In our Audit Planning Report, we identified a significant risk in relation to taking informed decisions, with a specific focus on:

- ▶ the transfer of trade and activities from the Arch Group to Advance Northumberland; and
- ▶ follow up of the modified conclusion for the prior year in relation to the governance and controls at the Advance Group.

We also considered the findings and observations from our additional procedures, which are set out in Section 5 of this report, against the criteria in Annual Guidance Note 03 issued by the National Audit Office. Taking together all of this information, we have concluded an adverse Value for Money Conclusion in respect of the Council's arrangements for taking informed decisions.

Further details of our findings are set out in the tables over the page.



Value for Money Risks

We are only required to determine whether there are any risks that we consider significant within the Code of Audit Practice, where risk is defined as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of enough work to deliver a safe conclusion on your arrangements to secure value for money, and enables us to determine the nature and extent of any further work needed. If we do not identify a significant risk we do not need to carry out further work.

The table below presents the findings of our work in response to the risks areas in our Audit Planning Report.

What is the significant value for money risk?	What arrangements did the risk affect?	What are our findings?
<p>In the year to 31 March 2019 the most significant transaction undertaken by the Council was the transfer of trade and activities from the Arch Group to Advance Northumberland in November 2018.</p> <p>We planned to review the information provided to key committees on this transaction, and the governance processes surrounding the transaction, to determine whether appropriate arrangements were in place for taking an informed decision.</p> <p>We also planned follow up on the modification to our Value for Money conclusion in 2017/18 to consider whether appropriate processes and controls to address the issue were in place for the financial year under audit.</p>	<p>Taking informed decisions</p>	<p>We have reviewed the Council's governance process for transferring the trade and activities of the Arch Group to Advance Northumberland and were satisfied that, materially, the appropriate process had been followed. However, we make the following observations:</p> <ul style="list-style-type: none">▶ Part of the rationale for the transaction that was presented to Cabinet on 14 June 2018 was the Group structure of Arch was not in line with Council's corporate plan; however we note that the Group structure of Advance Northumberland remains exactly the same as the Arch Group, as all of the Arch Corporate Holdings subsidiary companies were transferred to Advance Northumberland. It is our view that the same outcome could have been achieved by changing the name of Arch Corporate Holdings to Advance Northumberland at a significantly lower cost to the Council but this was not an option considered by Cabinet. In future we recommend that a full options appraisal is presented to Cabinet before taking significant decisions of this nature.▶ We also considered whether appropriate processes and controls were in place at the Council for managing the subsidiary companies, following on from our modifications to the Value for Money conclusions in 2016/17 and 2017/18. We noted that the papers presented to Cabinet for approval for the transfer of trade and activities from Arch to Advance Northumberland referred to improved governance arrangements between the Council and its subsidiaries being implemented upon establishment of the new company in November 2018. We also note that the formal operating agreement setting out the interactions between Advance Northumberland and the Council was not approved until June 2019. <p>We have therefore concluded that appropriate arrangements had not been in place for the whole of the financial year under audit.</p>



Value for Money Risks

On 17 March 2019 we received correspondence containing a number of allegations which we took forward under our procedures. On 2 August 2019, management provided consent for us to proceed with our additional procedures and the final pieces of evidence for our additional procedures were received on 10 September 2019. We are obliged to consider the impact of our findings and observations arising from our additional procedures on our Value for Money conclusion.

What is the significant value for money risk?	What arrangements did the risk affect?	What are our findings?
<p>As part of our additional procedures relating to the allegations received, we made observations regarding management culture, the independence of internal audit and the role of the finance function.</p> <p>We are obliged to consider the impact of these findings and observations on our Value for Money conclusion.</p>	Taking informed decisions	<p>The work undertaken in response to the allegations received can be summarised into the following broad themes:</p> <p>Turnover of Section 151 Officers</p> <p>Since May 2017, the Council has had three Section 151 Officers in post and is currently recruiting for a permanent appointment (we understand that the appointment of a new Section 151 Officer is in the final stages of the process). The high level of turnover in the post heightens the risk that the Council is unable to demonstrate how they are able to secure appropriate administration over their financial affairs as there is a loss of corporate knowledge and senior local government experience, when it comes to developing and approving budgets set.</p> <p>Maintenance of a sound system of internal control</p> <p>We identified potential threats to the independence of the Council's internal audit function including the Chief Internal Auditor taking on roles which could be perceived to be management functions and the employment of a close relative of a senior manager by the shared Internal Audit Service who worked on Council audits. The safeguards in the Public Sector Internal Audit Standards to prevent conflicts of interest in these areas had not been applied. We also observed that management did not recognise these threats to the perception of the independence and believed that, as the Chief Internal Auditor is employed by another body, independence was inbuilt into the arrangements.</p> <p>We have observed that there have been instances where the name of the Section 151 Officer has been added to public reports without their specific sign-off. This is a weakness in the report approval process and it could be misleading to the users of the report and other stakeholders and creates a risk that decisions are made on incomplete or inaccurate financial information.</p>



Value for Money Risks

What is the significant value for money risk?	What arrangements did the risk affect?	What are our findings?
<p>As part of our additional procedures relating to the allegations received, we made observations regarding management culture, the independence of internal audit and the role of the finance function.</p> <p>We are obliged to consider the impact of these findings and observations on our Value for Money conclusion.</p>	Taking informed decisions	<p>Management and cultural challenges</p> <p>The Council operates within a highly politically charged environment and we have observed a growing tension between the main political parties over the last few years. Management has commented that the politics of the Council can make it difficult to carry out their 'day job' and it is clear that the historical issues are still at the forefront of management's mind. The above factors create the potential to seriously impact on the Council's governance arrangements and there is a risk that improvements to management culture and governance are not being progressed as quickly as required.</p>

Overall conclusion

We have considered the criteria in AGN03 alongside the more detailed guidance on general arrangements in AGN03 supporting information under the VfM sub-criteria 'Taking informed decisions'. Whilst we accept that the examples identified are not exhaustive, we do note that a number translate to our findings at the Council, including:

- ▶ High turnover of those charged with governance (TCWG) or key operating personnel, or over-reliance on individuals. The organisation might be unable to respond appropriately to unplanned changes in the composition of key personnel, leading to loss of resources or reduced performance.
- ▶ Imbalance in the composition of TCWG between technical and sector experience. The organisation might be unsighted on either the wider environment or the operational activity, in turn leading to reactive rather than strategic decision making.

Specifically, we also considered the sub-criteria of the definition of 'Taking informed decisions' and consider that our findings, including our overall concerns over management culture and operating style are relevant to the following criterion:

- ▶ Acting in the public interest, through demonstrating and applying the principles and values of sound governance.

We have concluded that the specific matters identified, together with our concerns over important aspects of the culture and management's operating style, are individually and collectively significant to our value for money conclusion. Furthermore, the matters identified are of such a pervasive nature to the entity level control environment, and therefore on the Council's ability to 'take informed decisions', we have concluded that it is appropriate to issue an adverse VfM conclusion.



06 Other reporting issues





Other reporting issues

Consistency of other information published with the financial statements, including the Annual Governance Statement

We must give an opinion on the consistency of the financial and non-financial information in the Narrative Statement with the audited financial statements. We are satisfied that the Narrative Statement is consistent with the audited financial statements.

We must also review the Annual Governance Statement for completeness of disclosures, consistency with other information from our work, and whether it complies with relevant guidance. In our view, the Annual Governance Statement requires to be updated to reflect the material findings and observations identified as part of our additional procedures. We will discuss this with management and update the Audit Committee at the forthcoming meeting.

Whole of Government Accounts

Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review, and the nature of our report, is specified by the National Audit Office.

We are unable to complete our work in this area until we have a final set of financial statements.

Other reporting issues

On 4 October 2019 we received correspondence from the Chief Executive advising of the intention to propose the removal of EY as Local Auditor of the Council and associated entities at a full Council meeting to be held on 6 November. On 25 October, further correspondence from the Chief Executive advised that she was arranging to have the proposed removal of us as Local Auditor withdrawn as an item for consideration at the 6 November Council meeting, as there had been insufficient time to finalise the required report to meet the Council's established reporting and clearance processes. At the time of writing, we are not aware that a revised timetable has been put in place.

We have no other matters to raise at the time of writing this report.

Other powers and duties

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Authority to consider it or to bring it to the attention of the public (i.e. "a report in the public interest").

We also have a duty to make written recommendations to the Authority, copied to the Secretary of State, and take action in accordance with our responsibilities under the Local Audit and Accountability Act 2014.

[At the current time we have not had any requirement to use our other powers and under the Local Audit and Accountability Act 2014.]



07

Assessment of Control Environment



Assessment of Control Environment

Financial controls

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

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. We have identified the following matters that we draw to your attention:

- ▶ The fixed asset working papers are complex and require a large amount of manual manipulation by management. We recognise that management has undertaken a significant amount of work during 2018/19 to simplify the working papers; however due to the sizeable nature of the asset base held by the Council there still remains a higher level of risk of error whilst a spreadsheet based approach remains in place. We recommend that management consider whether they are able to accept the level of risk inherent in the current approach or whether they may want to look to introduce a more system-based approach to managing the asset base.
- ▶ The Council upgraded the general ledger to the Oracle Cloud in November 2018 and we noted that since the new system had been implemented, monthly key control account reconciliations were not being performed as management were unable to access the reports that they needed. We recommend that this is prioritised so that the full schedule of reconciliations is in place for 2019/20.

We have also made some observations in the additional procedures and value for money sections of the report about the entity level controls at the Council. We recommend that the Audit Committee agrees how the Council should take these observations forward.



9

Independence



Confirmation

We confirm that there are no changes in our assessment of independence since our confirmation in our Audit Planning Report presented in March 2019.

We complied with the FRC's Ethical Standards and the requirements of the terms and conditions in our engagement contract. 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.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your Audit Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the forthcoming meeting of the Audit Committee.

Fee analysis

As part of our reporting on our independence, we set out below a summary of the fees.

	Agreed fee 2018/19	Final fee 2017/18	Final Fee 2016/17
	£	£	£
Total Fee - Code work (scale fee)	119,800	197,612	190,956
Total Fee - Code work (variation)	20,800*	6,656***	19,000***
Total Fee - Code work (additional procedures re allegations received)	20,102**	-	-
Total Fee - Housing Benefit certification work	6,550	9,341	9,900
Total Audit fee	167,252	206,953	219,856
Non-audit work - Other certification work	4.925	15,000	15,000
Non-audit work - Tax advice	-	15,975	40,350
Total other non-audit services	4,925	30,975	55,350
Total fees	172,177	237,928	275,206

* In our Annual Audit Plan presented in March 2019 we highlighted that there were a number of one-off transactions in 2018/19 including the transfer of trade and activities from Arch to Advance Northumberland, the upgrade of the General Ledger, the implementation of new accounting standards and follow up of our modified value for money conclusion from 2017/18. The proposed fee variation for these matters set out in our Audit Plan presented to the March 2019 Audit Committee was £14,300. Additionally, since the Audit Plan was issued additional risks arose in respect of pensions and the valuation of the shares in Newcastle Airport. We have calculated the additional fees arising from this work to be £6,500.

** Following receipt of allegations, we shared with management at the time the allegations were received that we estimated around 15 days of additional partner and senior manager time to complete the additional work required. We committed to keeping management advised of the additional time incurred, as there was the potential for this to change. At the time of updating this report, we have incurred 26 days of time.

*** The fee variations for prior years were agreed with the previous s151 officer; however we have not yet received approval from Public Sector Audit Appointments Limited to issue invoices as required by our terms of appointment for those years.



10 Appendices



 Appendix A

Summary of communications

Date	Nature	Summary
17 October 2018 5 December 2018 6 February 2019 11 April 2019	Meeting	The partner in charge of the engagement, along with other senior members of the audit team, met with the Section 151 Officer in post at the time and the Chief Internal Auditor to discuss accounting developments and other matters arising during the course of the year.
27 March 2019	Report	The Audit Planning Report, including confirmation of independence, was presented to the Audit Committee.
11 July 2019	Meeting	Audit status meeting with the Interim Section 151 Officer to discuss the preliminary findings of the audit.
24 July 2019	Report	The draft Audit Results Report setting out the current status of work, including confirmation of independence, <i>was</i> presented to the Audit Committee.
25 September 2019	Meeting	We attended Audit Committee to explain that we were unable to present our Audit Results Report as discussions were ongoing with management on the factual accuracy of the content.
November	Report	Our updated Audit Results Report setting out our findings and conclusions from the additional procedures undertaken to assess the impact of the allegations received on our audit work, will be presented to the Audit Committee

In addition to the above specific meetings and other written communications, the audit team has met with management multiple times throughout the course of the audit to discuss audit findings. Additionally, there has been regular attendance at meetings of the Audit Committee.



Appendix B

Required communications with the Audit, Governance and Standards Committee

There are certain communications that we must provide to the Audit Committees of UK clients. We have detailed these here together with a reference of when and where they were covered:

Required communications	 What is reported?	 Our Reporting to you
		 When and where
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	Engagement Contract signed December 2017.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter.	Audit Planning Report - presented March 2019
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Planning Report - presented March 2019
Significant findings from the audit	<ul style="list-style-type: none">▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures▶ Significant difficulties, if any, encountered during the audit▶ Significant matters, if any, arising from the audit that were discussed with management▶ Written representations that we are seeking▶ Expected modifications to the audit report▶ Other matters if any, significant to the oversight of the financial reporting process	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019



Appendix B

		 Our Reporting to you
Required communications	 What is reported?	 When and where
Going concern	<p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	No conditions or events were identified, either individually or together to raise any doubt about Northumberland County Council's ability to continue for the 12 months from the date of our report.
Misstatements	<ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ Material misstatements corrected by management 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019
Subsequent events	<ul style="list-style-type: none"> ▶ Enquiry of the Audit Committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements. 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019
Fraud	<ul style="list-style-type: none"> ▶ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the Authority ▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▶ Unless all of those charged with governance are involved in managing the Authority, any identified or suspected fraud involving: <ul style="list-style-type: none"> a. Management; b. Employees who have significant roles in internal control; or c. Others where the fraud results in a material misstatement in the financial statements. ▶ The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected ▶ Any other matters related to fraud, relevant to Audit Committee responsibility. 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019



Appendix B

		Our Reporting to you	
Required communications	What is reported?	When and where	
Related parties	<p>Significant matters arising during the audit in connection with the Council's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the Authority 	<p>Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019</p>	
Independence	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence.</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence <p>Communications whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place.</p> <ul style="list-style-type: none"> ▶ Details of any inconsistencies between the Ethical Standard and Group's policy for the provision of non-audit services, and any apparent breach of that policy ▶ Details of any contingent fee arrangements for non-audit services ▶ Where EY has determined it is appropriate to apply more restrictive rules than permitted under the Ethical Standard ▶ The Audit, Governance and Standards Committee should also be provided an opportunity to discuss matters affecting auditor independence 	<p>Audit Planning Report - presented March 2019</p> <p>Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019</p>	



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		Our Reporting to you	
Required communications	What is reported?	When and where	
External confirmations	<ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures. 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019	
Consideration of laws and regulations	<ul style="list-style-type: none"> ▶ Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur ▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019	
Significant deficiencies in internal controls identified during the audit	<ul style="list-style-type: none"> ▶ Significant deficiencies in internal controls identified during the audit. 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019	



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		 Our Reporting to you
Required communications	 What is reported?	 When and where
Group Audits	<ul style="list-style-type: none"> ▶ An overview of the type of work to be performed on the financial information of the components ▶ An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ▶ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ▶ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ▶ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements. 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019
Written representations we are requesting from management and/or those charged with governance	<ul style="list-style-type: none"> ▶ Written representations we are requesting from management and/or those charged with governance 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019
Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	<ul style="list-style-type: none"> ▶ Material inconsistencies or misstatements of fact identified in other information which management has refused to revise 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019
Auditors report	<ul style="list-style-type: none"> ▶ Any circumstances identified that affect the form and content of our auditor's report 	Draft Audit Results Report - July 2019 Updated Audit Results Report - November 2019
Fee Reporting	<ul style="list-style-type: none"> ▶ Breakdown of fee information when the audit planning report is agreed ▶ Breakdown of fee information at the completion of the audit ▶ Any non-audit work 	Audit Planning Report - presented March 2019 Updated Audit Results Report - November 2019
Certification work	<ul style="list-style-type: none"> ▶ Summary of certification work 	Certification Report - later in 2019

 Appendix C

Management representation letter

Management Rep Letter

[To be prepared on Council letterhead]

[Date - same day as accounts signing]

Ernst & Young LLP
Atria One,
144 Morrison Street,
Edinburgh
EH3 8EX

Dear Sirs

This letter of representations is provided in connection with your audit of the consolidated and Council financial statements of Northumberland County Council ("the Group and Council") for the year ended 31 March 2019. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the consolidated and Council financial statements give a true and fair view of the Group and Council financial position of Northumberland County Council as of 31 March 2019 and of its financial performance (or operations) and its cash flows for the year then ended in accordance with, for the Group and Council, CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

We understand that the purpose of your audit of our consolidated and Council financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing, which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Financial Statements and Financial Records

We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with, for the Group and Council, the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

We acknowledge, as members of management of the Group and Council, our responsibility for the fair presentation of the consolidated and Council financial statements. We believe the consolidated and Council financial statements referred to above give a true and fair view of the financial position, financial performance (or results of operations) and cash flows of the Group and Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 and are free of material misstatements, including omissions. We have approved the consolidated and Council financial statements.

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The significant accounting policies adopted in the preparation of the Group and Council financial statements are appropriately described in the Group and Council financial statements.

As members of management of the Group and Council, we believe that the Group and Council have a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 for the Group and Council that are free from material misstatement, whether due to fraud or error.

We confirm that we have not made the following adjustment to the financial statements as we do not believe that it has a material impact on the accounts.

Dr Group Income from subsidiaries	£11.065 million
Cr Group Expenditure from subsidiaries.	£11.065 million

Non-compliance with Law and Regulations, including Fraud

We acknowledge that we are responsible for determining that the Group and Council's activities are conducted in accordance with laws and regulations and that we are responsible for identifying and addressing any non-compliance with applicable laws and regulations, including fraud.

We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.

We have disclosed to you the results of our assessment of the risk that the consolidated and Council financial statements may be materially misstated as a result of fraud.

We have disclosed to you, and provided you full access to information and any internal investigations relating to, all instances of identified or suspected non-compliance with law and regulations, including fraud, known to us that may have affected the Group or Council (regardless of the source or form and including, without limitation, allegations by "whistleblowers") including non-compliance matters:

- ▶ involving financial statements;
- ▶ related to laws and regulations that have a direct effect on the determination of material amounts and disclosures in the consolidated or Council's financial statements;
- ▶ related to laws and regulations that have an indirect effect on amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operations of the Group or Council's activities, its ability to continue to operate, or to avoid material penalties;
- ▶ involving management, or employees who have significant roles in internal controls, or others; or
- ▶ in relation to any allegations of fraud, suspected fraud or other non-compliance with laws and regulations communicated by employees, former employees, analysts, regulators or others.

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C. Information Provided and Completeness of Information and Transactions

We have provided you with:

- ▶ access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- ▶ additional information that you have requested from us for the purpose of the audit; and
- ▶ unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

All material transactions have been recorded in the accounting records and are reflected in the consolidated and Council financial statements.

We have made available to you all minutes of the meetings of the Group and the Council and committees (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the year to the most recent meeting on the following date: [list date].

We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Group and Council's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the year ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the consolidated and Council financial statements.

We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.

We have disclosed to you, and the Group and Council has complied with, all aspects of contractual agreements that could have a material effect on the consolidated and Council financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

Liabilities and Contingencies

All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the consolidated and Council financial statements.

We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.

We have recorded and/or disclosed, as appropriate, all liabilities related to litigation and claims, both actual and contingent, and have disclosed in the consolidated and Council financial statements all guarantees that we have given to third parties.

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Subsequent Events

There have been no events subsequent to year end which require adjustment of or disclosure in the consolidated and Council financial statements or notes thereto.

Group audits

There are no significant restrictions on our ability to distribute the retained profits of the Group because of statutory, contractual, exchange control or other restrictions other than those indicated in the Group financial statements.

Necessary adjustments have been made to eliminate all material intra-group unrealised profits on transactions amongst Council, subsidiary undertakings and associated undertakings.

Other information

We acknowledge our responsibility for the preparation of the other information. The other information comprises the Narrative Report.

We confirm that the content contained within the other information is consistent with the financial statements.

Reserves

We have properly recorded or disclosed in the consolidated and Council financial statements the useable and unusable reserves.

Use of the Work of a Specialist

We agree with the findings of the specialists that we engaged to evaluate the valuation of property and the valuation of shares in Newcastle International Airport Limited and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the consolidated and Council financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.

Retirement benefits

On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.



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Yours faithfully,

Section 151 Officer

Chair of the Audit Committee

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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