HASTINGS BOROUGH COUNCIL

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2016

EXECUTIVE SUMMARY

Purpose of the letter

This Annual Audit Letter summarises the key issues arising from the work that we have carried out in respect of the financial year ended 2015/16. It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public. It will be published on the website of Public Sector Audit Appointments Limited.

Responsibilities of auditors and the Council

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

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

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

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

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

BDO LLP
27 October 2016

Audit conclusions

FINANCIAL STATEMENTS

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

We reported our detailed findings to the Audit Committee on 22 September 2016. A small number of corrections were made to the final published accounts.

We also reported on areas where improvements in controls should be made including changes to supplier bank account details and compliance with controls for raising purchase orders.

USE OF RESOURCES

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

While the Council still has some work to do to close the funding gap in future years, and the planned use of earmarked and other reserves of £4.2 million over the next three years is clearly not sustainable in the longer term, this should be seen in the context of the Council having a high level of earmarked reserves (£7 million general reserves and £13 million earmarked at 31 March 2016) to manage the transition to becoming a lower spending authority.

EXERCISE OF STATUTORY POWERS

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

GRANT CLAIMS AND RETURNS CERTIFICATION

Our review of your housing benefits subsidy claim 2015/16 is in progress and the results will be reported upon completion of this work.

FINANCIAL STATEMENTS

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

Scope of the audit of the financial statements

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

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

Our assessment of risks of material misstatement

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

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

REVENUE RECOGNITION	RESPONSE	FINDINGS
Risks of fraud in revenue recognition may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue.	Our review of revenue recognition has focused on testing completeness and existence of fees and charges to check that income has been recorded in the correct period and that all income that should have been recorded has been recorded. We also tested an increased sample of grant income to ensure that the point of recognition was in line with Code requirements.	No issues have been identified by our testing of revenue from fees and charges or grant income.

FINANCIAL STATEMENTS
Continued

VALUATION OF LAND AND BUILDINGS	RESPONSE	FINDINGS
The valuations for land and buildings included in Property, Plant and Equipment (PPE) is estimated based on market values for existing use or depreciated replacement cost (DRC). There is a risk that the basis of valuation for these assets may not be appropriate or may not be supported by available valuation data. In line with the Council's 5 yearly rolling valuation programme, the external valuer has valued land and buildings with a closing net book value of £41.3 million as at 31 March 2016, representing 51% by value. This resulted in a net upwards revaluation movement of £0.6 million (excluding surplus assets as below) for PPE.	We reviewed the valuations provided and the valuation methodology applied, and confirmed that the basis of valuation for assets valued in year is appropriate based on the Code of Practice on Local Authority Accounting 2015/16 requirements. We compared the valuations to expected movements using available market information.	We concluded that the basis of the valuations was appropriate and that the valuation movements were within expectations.

VALUATION OF SURPLUS ASSETS / INVESTMENT PROPERTY	RESPONSE	FINDINGS
The Code of Practice on Local Authority Accounting 2015/16 introduced a change in the basis of valuation of surplus assets and investment properties under International Financial Reporting Standard (IFRS) 13 to a 'highest and best use' valuation. There is a risk that the valuations may fail to take into account the potential alternative uses of the properties in updating the valuations. The majority of surplus assets and investment properties were valued by the external valuer in line with the new IFRS13 requirements. This resulted in a net upwards revaluation movement of £5.2 million for surplus assets and £176,000 for investment properties.	We reviewed the valuations provided and the valuation methodology applied, and confirmed that the basis of valuation for assets valued in year is appropriate based on IFRS 13. We compared the valuations to expected movements using available market information.	We concluded that the basis of the valuations were appropriate and that the valuation movements were within expectations.

FINANCIAL STATEMENTS
Continued

PENSION LIABILITY	RESPONSE	FINDINGS
The pension liability comprises the Council's share of the market value of assets held in the East Sussex Pension Fund and the estimated future liability to pay pensions. An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation. At 31 March 2016 the net pension liability decreased by £6.0 million mainly as a result in the lower discount rate applied to the liabilities.	We have reviewed the reasonableness of the assumptions applied by comparing these to the expected ranges provided by an independent consulting actuary report. The key changes to the financial assumptions relate to: • uplift in salary increases from 4.0% to 4.1% • increase in the discount rate from 3.1% to 3.4% (to place a current value on the future liabilities through the use of a market yield of corporate bonds).	We are satisfied that the assumptions used are not unreasonable or outside of the expected ranges.

FINANCIAL STATEMENTS
Continued

ALLOWANCE FOR NON-COLLECTION OF RECEIVABLES	RESPONSE	FINDINGS
The Council estimates the proportion of debt due that it may not be able to recover and provides against this debt. This includes amounts due for housing benefit overpayments, council tax arrears and business rates arrears. The allowance for housing benefit overpayments decreased by £74,000 to £1.912 million following a reduction on the provision rate from 80% to 70% for all overpayments in the year. The allowance for council tax arrears is £3.897 million, a decrease of £371,000 from the prior year, against total arrears of £5.509 million. The Council has a 14.2% share in these balances. The allowance for NDR arrears is £831,000, an increase of £73,000 from the prior year, against total arrears of £1.130 million. The Council has a 40% share in these balances.	We reviewed the amounts provided for against the debt with collection rates achieved in recent years. For housing benefits overpayments, high level analysis suggests that actual collection rates could be higher (at around 60%) and that the allowance for non-recovery may be too high. For council tax arrears and NDR arrears the Council has calculated its provision by applying anticipated total collection rates to gross 2015/16 amounts receivable and provided 100% against balances outstanding from previous years. This methodology is likely to be on the prudent side, as historic experience shows that council tax and NDR amounts are often recovered several years after they fall due.	Overall we concluded that the impairment allowances for receivables are reasonable, although they are likely to be on the prudent side.

FINANCIAL STATEMENTS
Continued

Our application of materiality

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

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

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

The materiality for the financial statements as a whole was set at £1.74 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 2 per cent) which we consider to be one of the principal considerations for the Council in assessing financial performance.

We agreed with the Audit Committee that we would report all individual audit differences in excess of £52,000.

Audit differences

Management has made corrections to the draft financial statements which increased the net deficit by £139,000, and reduced the closing balance on earmarked reserves by the same amount.

Our audit found three audit differences not corrected in the final financial statements, which would increase the net deficit by £281,000. Unusable reserves would be reduced by the same amount, with the impact flowing to the general fund in the following financial period.

We consider that these misstatements did not have a material impact on our opinion on the financial statements.

Other matters we report on

Annual governance statement

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

Narrative reporting

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

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

FINANCIAL STATEMENTS
Continued

Internal controls

We did not find any significant deficiencies in internal controls during the course of our audit. However, a number of other areas for improvement were identified which we have discussed with management covering:

- Compliance with journal authorisation controls
- Changes to supplier bank details
- Following up corrections from quality control checks on housing benefit assessments
- Compliance with purchase order controls.

Whole of Government Accounts

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

The Council falls below the threshold for review and there is no requirement for further work other than to submit the section on the WGA Assurance Statement to the WGA audit team with the total values for assets, liabilities, income and expenditure.

USE OF RESOURCES

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

Scope of the audit of use of resources

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

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

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

Our assessment of significant risks

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

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

SUSTAINABLE FINANCES	RESPONSE	FINDINGS
The Council's Medium Term Financial Strategy (MTFS) was last refreshed in November 2015, and covers the period up to 2018/19. The forward budget was updated in February 2016 following the funding settlement for 2016/17, and now shows a balanced budget (after the use of reserves) in 2016/17, followed by a £0.5 million funding shortfall in 2017/18, and a £1.5 million shortfall in 2018/19. There is a risk that the Council does not have appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.	We reviewed the Council's plans to close the budget gaps though savings, efficiencies and income growth. The original 2015/16 budget set in February 2015 set net Council expenditure of £17.2 million (excluding the planned utilisation of reserves). Actual net Council expenditure was lower than budget at £15.6 million. Grant and taxation income was also £0.5 million above budget. The total favourable variance of £2.1 million meant that the planned drawdown of earmarked and other reserves of £2.1 million in year was in fact not required. (Continued)	We have reviewed the major assumptions underpinning the MTFS, and we are satisfied that these are broadly reasonable. We note that there is no formal reporting on the outcomes of the proposed efficiency measures and actual savings generated, and this may be something the Council wishes to consider in the future to further enhance the process and ensure that the actions being taken are effective. (Continued)

USE OF RESOURCES
Continued

SUSTAINABLE FINANCES	RESPONSE	FINDINGS
	Significant variances from plan included a £503,000 underspend on housing benefit payments which are largely demand driven, a £136,000 underspend on financial services related to severance payments, and a £106,000 underspend on rogue landlords following the receipt of additional funding. The budget assumed savings of £1.0 million from the PIER process in 2015/16, and further savings of £0.5 million in 2016/17, and £0.7 million in each of 2017/18 and 2018/19 have been built into the latest budget round. The source of the savings has been identified and is set out in full within the Council's budget document. We note that the proposed savings for 2016/17 and 2017/18 have been reduced significantly from those set out within the February 2015 budget, when figures of £1.7 million and £1.8 million respectively were quoted. The net underspend in year, which followed a net underspend against original budget of £2.6 million in 2014/15, provides evidence that the Council is successfully managing to reduce net expenditure, which will be partly through driving efficiencies identified through the PIER process.	It is clear that the Council still has some work to do to close the funding gap in future years, and the planned use of earmarked and other reserves of £4.2 million over the three-year period from 2016/17 to 2018/19 is clearly not sustainable in the long term. However, this should be seen in the context of the fact that the Council has a high level of earmarked reserves (£7 million general reserves and £13 million earmarked at 31 March 2016), which places it in the highest 5% of all district councils. Therefore, some planned usage of these reserves in the medium term will not pose a threat to the long term sustainability of the Council, provided that efforts to transition to a lower cost Council are successful.

EXERCISE OF STATUTORY POWERS

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

Use of statutory powers

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

Audit certificate

We issued the audit certificate to close the audit for the year ended 31 March 2016 on 30 September 2016.

GRANT CLAIMS AND CERTIFICATION

CERTIFICATION WORK	Our review of your housing benefits subsidy claim 2015/16 is in progress and the results will be reported upon completion of this work.

Housing benefit subsidy claim

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

Our audit of the 2014/15 housing benefits subsidy claim found a number of errors in relation to misclassified overpayments and earnings calculations. The Council was also unable to reconcile the total value of benefits generated to the amount posted from the benefits system.

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

APPENDIX

Reports issues

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

REPORT	DATE
Audit Plan	9 March 2016
Grant claims and certification work 2014/15	25 March 2016
Final audit report	14 September 2016
Annual Audit Letter	27 October 2016

Fees

We reported our original fee proposals in our Audit Plan.

AUDIT AREA	PLANNED FEES	FINAL FEES
Code audit	46,418	46,418
Certification of housing benefits subsidy	8,844	8,844
Fee for audit services	55,262	55,262
Audit related services: - None	-	-
Non audit related services: - None	-	-

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