

# Hertsmere Borough Council

Annual Audit Letter for the year ended 31 March 2017

September 2017

Ernst & Young LLP



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Public Sector Audit Appointments Ltd (PSAA) have issued a “Statement of responsibilities of auditors and audited bodies”. It is available from the Chief Executive of each audited body and via the PSAA website ([www.psa.co.uk](http://www.psa.co.uk))

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The “Terms of Appointment (updated 23 February 2017)” issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure - If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

A close-up photograph of a person's hand holding a blue pen and writing on a document. The hand is positioned on the right side of the frame. In the background, a laptop is open, and a calculator is visible on the desk. To the left, a white mug is partially visible. The scene is brightly lit, likely from a window, creating a professional and focused atmosphere. A yellow rectangular box is overlaid on the left side of the image, containing the text 'Executive Summary'.

## Executive Summary

## Executive Summary

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

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2017 and of its expenditure and income for the year then ended
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 31 July 2017
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 1 August 2017

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

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

Andrew Brittain

Executive Director  
For and on behalf of Ernst & Young LLP

Purpose



## Purpose

### The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report to the 31 March 2017 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.





Responsibilities



## Responsibilities

### Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued on 30 January 2017 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
  - ▶ On the 2016/17 financial statements; and
  - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
  - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - ▶ Any significant matters that are in the public interest;
  - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return.

## Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

A blurred office desk with a laptop, glasses of water, and financial documents. The scene is brightly lit, likely from a window with blinds in the background. A yellow rectangular box is overlaid on the left side of the image, containing the text 'Financial Statement Audit'.

# Financial Statement Audit

## Financial Statement Audit

### Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 1 August 2017.

Our detailed findings were reported to the 31 July 2017 Audit Committee.

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

Significant Risk	Conclusion
<p>Management override of controls</p> <p>A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p>	<p>We have not identified any material weaknesses in controls or evidence of material management override.</p> <p>We have not identified any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Authority's normal course of business</p>
<p>Revenue and expenditure recognition</p> <p>Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.</p> <p>We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at</p>	<p>Our testing has not identified any material misstatements from revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Authority's financial position.</p>



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the year end.

For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.

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#### Valuation of Other Land and Buildings

After conducting our initial procedures we needed additional assurance over the valuations, and their basis, provided by the Council's external specialist. This required us our valuations specialists to undertake additional procedures by which we were able to conclude that the valuation movements are supported by the valuations provided and that the overall basis of valuation is reasonable.

However, our work identified a number of issues with the depreciated replacement cost methodology (DRC) applied. Those which could have a material impact on the Hertsmere valuations are listed below:

- Treatment of professional fees was incorrect, potentially overstating asset values
- Land values have been calculated as a percentage of building values rather than market value

The additional work we conducted, with the support of our valuation specialists, was to quantify the possible error. The treatment of professional fees resulted in an overstatement of approximately £1 million, whereas the use of building values to determine land valuations resulted in an understatement of approximately the same magnitude.

On this basis, we were able to conclude that the overall valuation was appropriate. We required disclosure amendments to explain the estimation uncertainty arising the valuation methodology.

Valuations are a matter of professional judgement; however, there are further steps that the Authority can take to ensure that the methodology adopted is appropriate.

Potential improvements:

- Revise the valuation instructions to ensure that key judgements and assumptions, and in particular any departures from the Red Book, are fully
-

- disclosed in the valuation report;
- Critically assess these judgements and make further inquiries of the valuer where necessary to understand their potential impact on the carrying value of assets;
- Going forward, land values should be assessed based on market value in accordance with the Code of Practice on Local Authority Accounting.

## Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We planned our procedures using a materiality of £1,464,000. We reassessed this using the actual year-end figures, which has increased this amount to £1,474,000. The basis of our assessment of materiality has remained consistent with prior years at 2% of gross revenue expenditure.
Reporting threshold	The threshold for reporting audit differences has increased from £73,000 to £73,736.

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits; we applied a lower threshold for errors (£1,000) and any error that would affect the banding (where applicable to the note).
- Members' allowances; we applied a lower threshold for errors (£1,000).
- Related party transactions; the accounting standard requires us to consider the disclosure from the point of materiality of either side of the transaction we therefore considered this on a case by case basis.

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

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

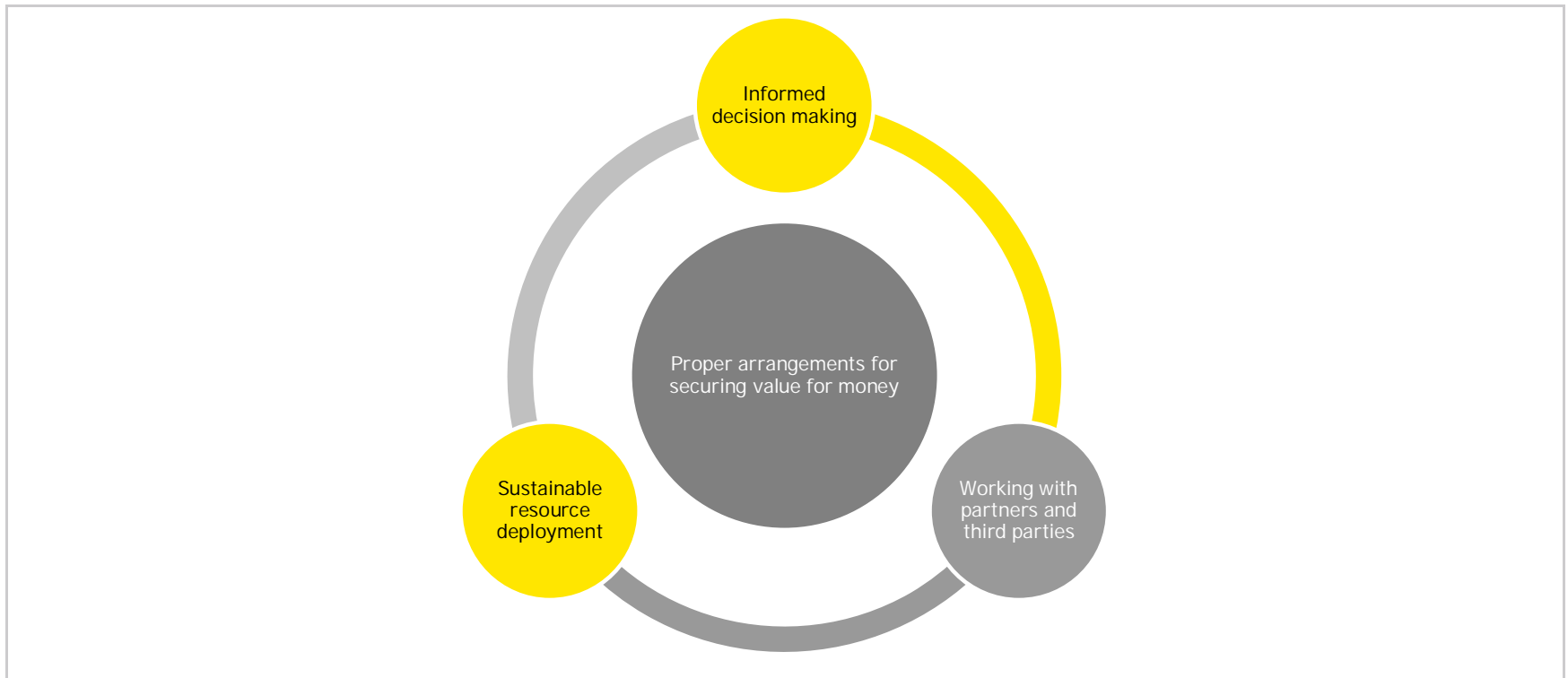
Value for Money

## Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.





We did not identify any significant risks in relation to these criteria

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

We therefore issued an unqualified value for money conclusion on 1 August 2017.



Other Reporting  
Issues

## Other Reporting Issues

### Whole of Government Accounts

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

### Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We recommended some changes be made to the statement specifically to include reference to how the Council ensures the effectiveness of the system of internal control as it applies to its group activities (Elstree Film Studios). The Council amended the annual governance statement to include these areas.

### Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

### Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

### Objections Received

We did not receive any objections to the 2016/17 financial statements from member of the public.

### Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

## Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 31 July 2017. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

## Control Themes and Observations

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 not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

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



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

Focused on your  
future

## Focused on your future

Area	Issue	Impact
<p><i>IFRS 15 Revenue from Contracts with Customers</i></p>	<p>Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except:</p> <ul style="list-style-type: none"> <li>• Leases;</li> <li>• Financial instruments;</li> <li>• Insurance contracts; and</li> <li>• for local authorities; Council Tax and NDR income.</li> </ul> <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>There are transitional arrangements within the standard; however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be.</p>	<p>Some initial thoughts on the approach to adopting IFRS 15 have been issued by CIPFA. However, until the Code is issued there remains some uncertainty. However, what is clear is that for all material income sources from customers the Council will have to:</p> <ul style="list-style-type: none"> <li>• Disaggregate revenue into appropriate categories</li> <li>• Identify relevant performance obligations and allocate income to each</li> <li>• Summarise significant judgements</li> </ul> <p>The Council is awaiting clarification of the exact requirements before investing time in the above work.</p>
<p><i>IFRS 16 Leases</i></p>	<p>IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease in a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard, although as the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be or whether any statutory overrides will be introduced.</p>	<p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to classify all of its leases and therefore must ensure that all lease arrangements are fully documented.</p> <p>The Council is has yet to commence work in this area due to the timing of implementation.</p>

Appendix A

# Audit Fees





## Appendix A Audit Fees

Our final fee includes a proposed scale fee variation which is subject to approval by Public Sector Audit Appointments:

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work	56,347	49,366	49,366	59,677
Total Audit Fee – Certification of claims and returns	TBC	16,290	16,290	24,170

The Scale fee variation of £6,981 (15/16: £10,311) is broken down as follows:

£3,947 – Relating to the group accounts procedures undertaken

£3,034 – Relating to the additional work undertaken in relation to asset valuations for specialised assets as noted at pages 11 and 12.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.



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ED None

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