

Hertsmere Borough Council

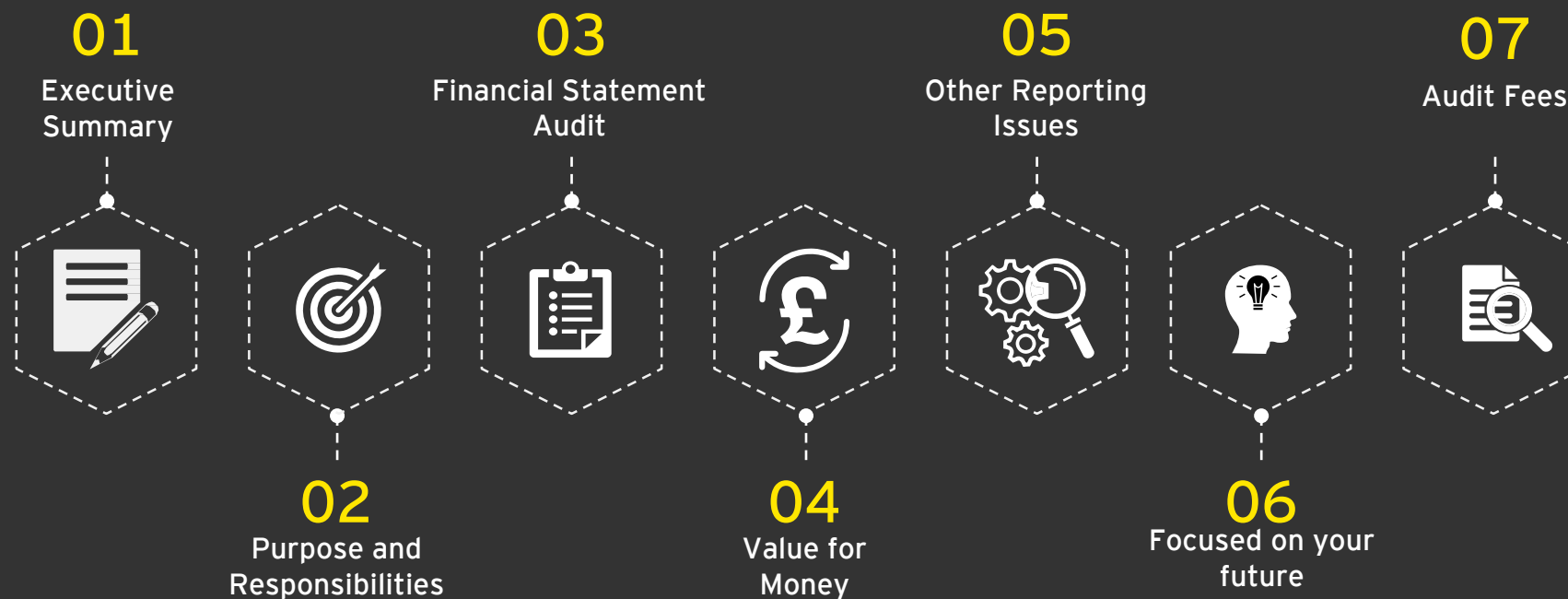
Annual Audit Letter for the year
ended 31 March 2018

August 2018

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing downwards towards the letters.

Building a better
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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psa.co.uk)

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

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

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

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



01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to **Hertsmere Borough Council** following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

| Area of Work | Conclusion |
|--|--|
| Opinion on the Council's: ► Financial statements | Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended. |
| ► Consistency of other information published with the financial statements | Other information published with the financial statements was consistent with the Annual Accounts. |
| Concluding on the Council's arrangements for securing economy, efficiency and effectiveness | We concluded that you have put in place proper arrangements to secure value for money in your use of resources |

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

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



Executive Summary (cont'd)

As a result of the above we have also:

| Area of Work | Conclusion |
|---|---|
| Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit. | Our Audit Results Report was issued on 19 July 2018 |
| Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice. | Our certificate was issued on 30 July 2018 |

In December 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken. We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Andrew Brittain
Associate Partner
For and on behalf of Ernst & Young LLP



02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

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

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the 30 July 2018 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 of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued on March 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2017/18 financial statements and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of our review, and the nature of our report, is specified by the National Audit Office. The Council is below the threshold that triggers additional procedures for the Return.

Responsibilities of the Council

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

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



03

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health. We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 30 July 2018. Our detailed findings were reported to the 30 July 2018 Audit Committee.

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

Significant Risk

Risk of fraud in revenue and expenditure recognition including management override of control

Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. 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. ISA240 also recognises 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. The manipulation of revenue or expenditure would occur through management override of control. In our Audit Planning Report we had presented these risks separately but given the inherent link in the work required to address them we are reporting our response and findings in respect of both of these risks together in the sections below.

In response to the risk, we:

- Enquired of management about risks of fraud and the controls in place to address those risks;
- Considered the oversight given by those charged with governance of management's processes over fraud by direct enquiry;
- Considered the effectiveness of management's controls designed to address the risk of fraud;
- Reviewed and tested revenue and expenditure recognition policies;
- Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements;
- Reviewed accounting estimates for evidence of management bias;
- Evaluated the business rationale for any significant unusual transactions;
- Reviewed and tested revenue and expenditure cut-off at the period end date;
- Tested a sample of capital expenditure to verify that revenue costs have not been inappropriately capitalised;
- Reviewed the basis for calculating the bad debt and non domestic rates appeals provisions;
- Verified that adjustments between the accounting basis and funding basis have been correctly made in accordance with the Code.

Conclusion

- We obtained the responses we requested from management and those charged with governance to our enquiries and used these to inform our understanding of fraud risks. We noted that key elements of the entity level control framework that we would expect to see, especially arrangements for internal audit, and risk management, were in place.
- Our walkthrough testing included considering what controls are in place to address significant risks. We concluded that these are in large part year end processes including management review of the draft financial statements. We confirmed that these controls were in place, although our approach was not to rely on controls.
- Our testing of income and expenditure items did not identify any material errors.
- We reviewed a sample of journals using a number of criteria and did not identify any inappropriate use of journals.
- Our work on the testing of accounting estimates was completed satisfactorily and no significant issues identified.
- We did not identify any other transactions during our audit which appeared unusual or outside the Authority's normal course of business.
- We did not identify any material cut-off issues at the period end date.
- Our testing of a sample of capital expenditure items found that these had been appropriately treated as capital.
- The majority of the bad debt provision is in respect of housing benefit overpayments, we agreed the basis of the provision. We are satisfied that the non domestic rates appeals provision is appropriately calculated.
- We have not identified any material weaknesses in controls or evidence of material management override.
- We have not identified any instances of inappropriate judgements being applied.

Overall, our audit work did not identify any material issues, inappropriate judgements or unusual transactions which indicated that there had been any misreporting of the Authority's financial position, that revenue or expenditure had been incorrectly recorded or that management had overridden control.

Financial Statement Audit (cont'd)

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

| Significant Risk | Conclusion |
|--|---|
| <p>Risk of fraud in revenue and expenditure recognition including management override of control</p> <p>In addition in respect of Elstree Film Studios Ltd planned procedures included:</p> <ul style="list-style-type: none">• Reviewing and testing revenue recognition policies• Reviewing and discussing with management any accounting estimates on revenue recognition for evidence of bias• Developing a testing strategy to test material revenue streams• Reviewing and testing revenue cut-off at the period end date. | <p>We reviewed the work of the component auditor and considered that this adequately covered the work required and we agreed with the conclusions drawn that there were no material issues.</p> |

Financial Statement Audit (cont'd)

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

| Other Key Findings | Conclusion |
|--|---|
| <p>Property, plant and equipment valuation</p> <p>Property, plant and equipment (PPE) represent significant balances in the Authority's accounts and are subject to valuation changes, impairment reviews and/or depreciation charges.</p> <p>Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet.</p> | <p>Our approach focused on:</p> <ul style="list-style-type: none">▪ Considering the work performed by the Authority's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.▪ Using our EY Valuers to review the response to audit enquiries made to Wilks Head Eve LLP regarding their approach and methodology where employed by our local government clients;▪ We referred one valuation (Bushey Golf and Country Club) to our EY Valuers due to the significant reduction in value of the land for this asset;▪ Reviewing what information on the asset base was provided to the valuer by the Authority to inform the updated valuation; and▪ Testing accounting entries have been correctly processed in the financial statements. <p>The EY Valuer reported back to the audit team that they considered that the valuation of the Bushey Golf and Country Club was reasonable in the circumstances but that the value of this asset needs to be revisited when its future becomes clearer. We concluded that the Council's property, plant and equipment were appropriately valued and presented in the financial statements.</p> |
| <p>Pension liability valuation</p> <p>The Local Authority Accounting Code of Practice (the Code) and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hertfordshire County Council.</p> <p>The Council's pension fund deficit is a material and sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2018 this totalled £35.5m.</p> | <p>The Council amended the draft statement of accounts to reflect an up to date estimate from the actuary of its share of the Hertfordshire Pension Fund asset value as at 31st March 2018. The statement of accounts had been prepared based on IAS19 data and assumptions taken as at December 2017, with a forecast of the 31 March 2018 position. The Hertfordshire Pension Fund accounts included an up to date estimate of the fund asset value as at 31 March 2018, and this was £67million higher reflecting improvements in market conditions. Hertsmere Borough Council's share of this difference in estimate was £1.408 million. As this difference was above our performance materiality (but below our planning materiality), the Council agreed to adjust its financial statements and disclosures to reflect this up to date estimate. The Council obtained from its actuary up to date IAS19 disclosures which were reflected in the accounts.</p> |

Financial Statement Audit (cont'd)

Our application of materiality

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

| Item | Thresholds applied |
|----------------------|--|
| Planning materiality | We determined planning materiality to be £1.48mn (2017: £1.47mn), which is 2% of gross expenditure reported in the accounts. Group planning materiality was £1.492m (2017:£1.52mn). We consider expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council. |
| Reporting threshold | We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £74k (2017: £73.7k). Our threshold for reporting misstatements at group level was £74.6k (2017:£76.5k). |

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:

- ▶ Members' allowances: errors above £10k would be considered significant.
- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits: errors above £1k and that affect the banding would be considered significant

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



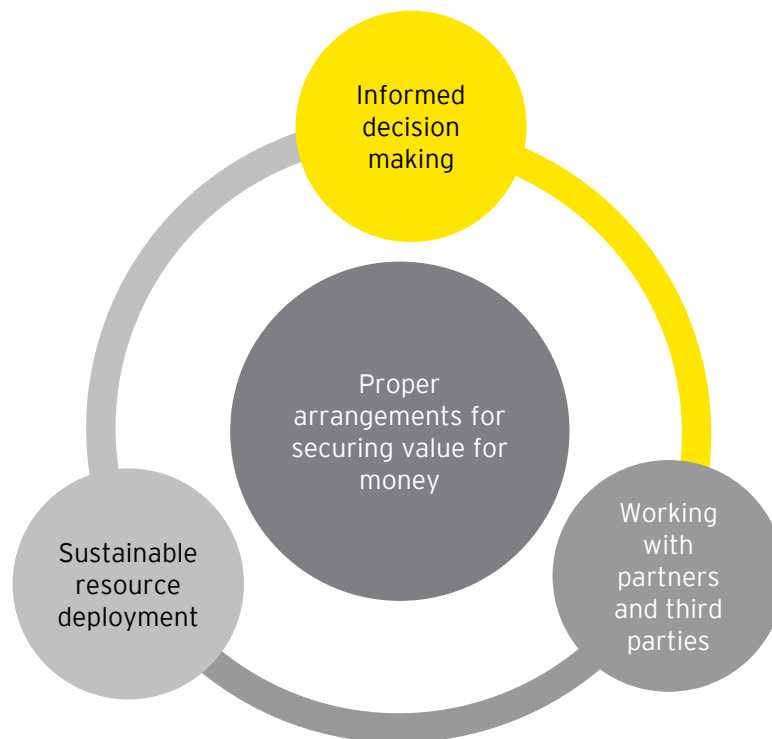
04 Value for Money

£ Value for Money

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

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

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



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

We performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements.

We therefore issued an unqualified value for money conclusion on 30 July 2018



05

Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. The Council was below the threshold that triggers additional procedures.

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 highlighted to officers the need to bring together the Annual Governance Statement, the associated action plan and the Local Code of Governance. SIAS also made some revisions to the Annual Governance Statement in the light of feedback provided by CIPFA on the 2016/17 Annual Governance Statement.

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.

Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Powers and Duties

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

Independence

We communicated our assessment of independence in our Audit Results Report to the 30 July 2018 Audit Committee. 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 Authority 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 Authority 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.



06

Focused on your future



Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. These are set out below however the impact on the Council is not considered to be significant.

| Standard | Issue | Impact |
|--|---|---|
| IFRS 9 Financial Instruments | <p>Applicable for local authority accounts from the 2018/19 financial year and will change:</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 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.</p> | <p>Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty.</p> |
| IFRS 15 Revenue from Contracts with Customers | <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"> ▶ Leases; ▶ Financial instruments; ▶ Insurance contracts; and ▶ For local authorities; Council Tax and NDR income. <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>Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.</p> | <p>The applicable accounting framework is CIPFA's annual Code of Practice on Local Authority Accounting in the United Kingdom (which is IFRS based as adapted for Local Authorities). The 2018/19 Code will apply to accounting periods starting on or after 1 April 2018 but has not yet been published. The 2018/19 Code will determine how IFRS 15 Revenue from Customers with Contracts will be adopted by local government bodies.</p> |



Focused on your future (cont'd)

| Standard | Issue | Impact |
|-----------------------|---|---|
| IFRS 16 Leases | <p>It is currently proposed that 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 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 and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p> | <p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> |

A close-up photograph of a person's hand reaching into a filing cabinet to touch a folder. The cabinet is filled with numerous folders of various colors (yellow, blue, white) and sizes, each containing stacks of papers. The background is a textured, light-colored wall.

07 Audit Fees

Audit Fees

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2018. Our fee for 2017/18 is in line with the scale fee set by the PSAA and reported in our July 2018 Audit Plan/Annual Results Report.

| | Final Fee 2017/18 | Planned Fee 2017/18 | Scale Fee 2016/17 | Final Fee 2016/17 |
|------------------------------------|----------------------|------------------------|----------------------|----------------------|
| | £ | £ | £ | £ |
| Total Audit Fee - Code work | 55,366* | 49,366 | 49,366 | 56,347 |
| Non-audit work | 0 | 0 | 0 | 0 |
| Total audit services | 55,366* | £49,366 | £49,366 | £56,347 |

Note that the planned and scale fee figures for 2017/18 do not include any amount for the audit of the group accounts. The scale fee for 2016/17 was £49,366, the additional amount to cover the group accounts was £3,947. An additional amount of £3,034 was charged in 2016/17 in respect of the review of the valuations of specialist assets.

* We are proposing an additional fee for 2017/18 of £6,000, this is £4,500 for the audit work on the group accounts and £1,500 for the review of a valuation of a property asset by one of our EY Valuers. We will liaise with the Corporate Director on any addition to our fee. Any increase to the planned fee has to be approved by PSAA.

We confirm that we have not undertaken non-audit work outside the PSAA Code.

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