

# Darlington Borough Council

Annual Audit Letter for the year ended 31 March 2016

October 2016

Ernst & Young LLP



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In April 2015, Public Sector Audit Appointments Ltd (PSAA) issued the 'Statement of responsibilities of auditors and audited bodies 2015-16'. 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 from 1 April 2015' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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

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

## Executive Summary

## Executive Summary

We are required to issue an annual audit letter to Darlington Borough Council (the Council) following completion of our audit procedures for the year ended 31 March 2016.

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

Area of Work	Conclusion
<b>Opinion on the Council's:</b> ▶ Financial statements	Unqualified - the financial statements give a true and fair view of the financial position of the Council as at 31 March 2016 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.
<b>Concluding on the Council's arrangements for securing economy, efficiency and effectiveness</b>	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

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

Area of Work	Conclusion
<b>Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).</b>	The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

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 presented to the Audit Committee on 30 September 2016.
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 September 2016.

In January 2017, 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.

Nicola Wright  
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 2015/16 Audit Results Report to the Audit Committee on 30 September 2016, 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 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued in March 2016 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 2015/16 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 Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on 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 Annual Governance Statement, 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.

# 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 September 2016.

Our detailed findings were reported to the Audit Committee on 30 September 2016.

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

Significant Risk	Conclusion
<p><b>Management override of controls</b></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 performed the following procedures to mitigate this risk:</p> <ul style="list-style-type: none"> <li>▶ Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;</li> <li>▶ Reviewed accounting estimates for evidence of management bias; and</li> <li>▶ Evaluated the business rationale for any significant unusual transactions.</li> </ul> <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 Council's normal course of business.</p>
<p><b>Revenue and expenditure recognition</b></p> <p>Auditing standards also required us to presume that there is a risk that revenue may be misstated due to improper recognition or manipulation.</p>	<p>In response to the risk of revenue and expenditure recognition we:</p> <ul style="list-style-type: none"> <li>▶ Reviewed and tested revenue and expenditure recognition policies;</li> <li>▶ Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias, including significant</li> </ul>

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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.

- ▶ provisions and accruals, and criteria for recognition of grant income;
- ▶ Developed a testing strategy to test material revenue and expenditure streams, with a particular focus on the completeness of expenditure; and
- ▶ Reviewed and tested revenue recognition and cut-off at the period end of grant income with specific conditions attached.

Our testing has not revealed any material misstatements with respect to revenue and expenditure recognition.

Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the Council's financial position.

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**Valuation of land and buildings**

As at 31 March 2016, the total value of land and buildings was £97 million which represents 28% of the Council's total assets.

Land and buildings are initially measured at cost and then revalued to fair value. Revaluations are performed with sufficient regularity to ensure that carrying amounts are not materially different from those that would be determined at the end of the reporting period.

The valuations are based on a number of complex assumptions. Given the high value of these assets, a small change in these assumptions can lead to a material change in value and have a material impact on the financial statements.

In response to this risk we:

- ▶ Reviewed the output of the Council's valuer;
- ▶ Tested the assumptions used by the Council's valuer by reference to external evidence and the CIPFA code of practice on local authority accounting; and
- ▶ Tested the journals for the valuation adjustments to confirm that they have been accurately processed in the financial statements.

We concurred with the methodology and basis of the valuation adopted.

During our testing we identified that the valuation of Muscar Farm was understated by £5.1m. This was due to an arithmetical error in the working paper received from the valuer. An adjustment has been made in the accounts to correct the valuation. No further arithmetical errors were identified in the working papers received from the valuer.

We have no further matters to report arising from our work.

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During the performance of our audit we also identified the following:

Other Key Findings	Conclusion
<p><b>Fixed Asset Register</b> We identified through our testing of property, plant and equipment that there is a difference between the value of assets showing on the fixed asset register when compared to the value included in the general ledger. We understand that this difference has existed since 2014/15, with the value on the fixed asset register being £2.4m higher for land and buildings, but £0.3m lower for investment properties.</p>	<p>Our testing of fixed asset movements in year has given us assurance that the balance included in the accounts is not materially misstated and as a result this does not impact upon our audit opinion. However we recommend that this difference is investigated and any amendments to the fixed asset register made as appropriate.</p>

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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".

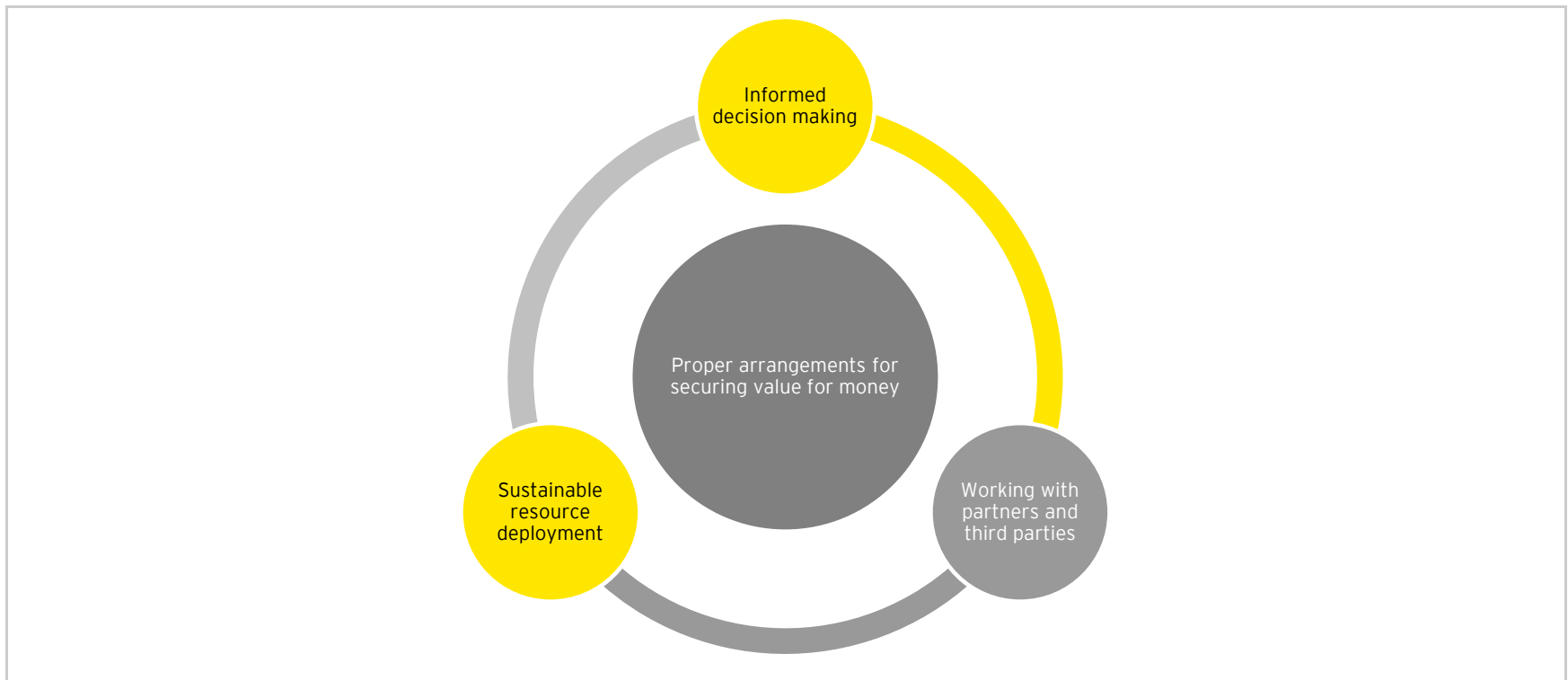
Value for Money

## 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 issued an unqualified value for money conclusion on 30 September 2016.

## Key Findings

### Financial planning

As part of our work on the value for money opinion we also considered the financial position and medium-term financial plan of the Council and noted that:

- ▶ The medium-term financial plan forecasts a balanced budget for the next four years assuming cost savings of around £10m across the four years of the plan; and
- ▶ Over the course of the medium-term financial plan the Council's reserves will diminish and spending will be reduced to minimal levels. However, the Council have established plans to deal with these factors, although any further reductions in funding will be very challenging for the Council.

We do note that as the financial position becomes more challenging over the medium term and levels of reserves reduce this may have an impact on our future value for money opinions and therefore we expect that we may need to carry out more work in this area in future years.

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### Children's services Ofsted Inspection

We identified a significant risk to our value for money conclusion in respect of the ongoing Ofsted review of the Council's Children's services. Following our review of correspondence from both the Department for Education and Ofsted, we noted that improvements have been made in the services offered. Although further improvements are required, our discussions with senior officers and review of documentation has provided assurance that plans are in place and monitored to further improve the services and as a result we are satisfied that there is no impact on our value for money opinion.

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## Other Reporting Issues

## Other Reporting Issues

### Whole of Government Accounts

The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

### Annual Governance Statement

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

We completed this work and did not identify any areas of concern.

### Report in the Public Interest

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

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

### Written Recommendations

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

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

### Objections Received

We did not receive any objections to the 2015/16 financial statements from members of the public.

### Other Powers and Duties

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

## Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 30 September 2016. 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 outlined in regulatory and professional requirements.

## Control Themes and Observations

We have adopted a fully substantive approach and have therefore not tested the operation of controls. We did identify one recommendation as set out above relating to:

- ▶ The need to ensure the quality review process relating to valuation certificates received from the internal valuer is sufficiently robust to identify significant errors.

No other control observations have been identified.

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
Highways Network Assets	The Code of Practice on local authority accounting in the United Kingdom 2016/17 (the Code) and the Code of Practice on the Highways Network Asset (HNA Code) sets out new requirements for accounting for highways network assets. The changes will impact significantly on the Council's accounts preparation and closedown timetable.	We will work with management to understand the impact of the changes and perform testing of the proposed changes during the interim phase of the audit.
EU referendum	The decision of the UK to begin the process of leaving the EU has introduced a period of uncertainty for the UK and indeed Global economy. The Leave vote is likely to lead to a significant impact for the public sector as it will be the sector that has to deliver the implementation of the decision. We have had a change of Prime Minister and other changes to the cabinet as a result. This level of political change and uncertainty will only increase uncertainty both within the public sector and in the business world.	<p>Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the net economic impact of the vote to leave the EU results in further constraints on public sector spending which require more innovative solutions.</p> <p>We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will talk with you on the concerns and questions you may have and provide our insight at key points along the path.</p>

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ED None

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