



Darlington Borough
Council

Annual Audit Letter for the year
ended 31 March 2018

August 2018



EY

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 Managing Director of the 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 associate partner 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 Darlington Borough Council (“the 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 financial statements.
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 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
Reporting to the National Audit Office (NAO) on our review of the Council’s Whole of Government Accounts return (WGA)	The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the consolidation pack.

Executive Summary (continued)

As a result of the areas on the previous page, 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 26 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 27 July 2018.

In February 2019, 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
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 26 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 Planning Report that we issued in March 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), 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 Council is below the specified audit threshold of £500m. 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 (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.



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 other guidance issued by the National Audit Office, and issued an unqualified audit report on 27 July 2018.

Our detailed findings were reported to the 26 July 2018 Audit Committee.

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

Significant Risk

Misstatements due to fraud or error

As identified in ISA (UK) 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.

Conclusion

We performed the following testing in relation to this risk:

- We identified fraud risks during the planning stage of our audit;
- We inquired of management about risks of fraud and the controls put in place to address those risks;
- We developed our understanding of the oversight given by those charged with governance over management's processes over fraud;
- We considered the effectiveness of management's controls designed to address the risk of fraud;
- We determined an appropriate strategy to address those identified risks of fraud; and
- We performed mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements.

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

We did not identify any instances of inappropriate judgements being applied.

Financial Statement Audit (continued)

Significant Risk	Conclusion
<p>Risk of fraud in revenue and expenditure recognition</p> <p>Under ISA 240 (UK), 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.</p> <p>Local authorities have a statutory duty to balance their annual budget and are operating in a financially challenged environment with reducing levels of government funding and increasing demand for services. Achievement of budget is critical to minimising the impact and usage of the Council's usable reserves and provides a basis for the following year's budget. Any deficit outturn against the budget is therefore not a desirable outcome for the Council and management, and therefore this desire to achieve budget increases the risk that the financial statements may be materially misstated.</p>	<p>We performed the following testing in relation to this risk:</p> <ul style="list-style-type: none"> • We reviewed and tested revenue and expenditure recognition policies; • We reviewed, discussed with management, and tested (where appropriate) any accounting estimates on revenue or expenditure recognition for evidence of bias; • We tested material revenue and expenditure streams, including testing revenue and capital expenditure to ensure it has been correctly classified; 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. <p>Our testing did not identify any material misstatements relating to revenue and expenditure recognition.</p> <p>We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.</p>

Other Key Findings	Conclusion
<p>Pension Liability Valuation</p> <p>The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet.</p> <p>The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Council.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>We performed the following testing in relation to this risk:</p> <ul style="list-style-type: none"> • We have liaised with the auditor for the Durham County Council Pension Fund to obtain assurances over the information supplied to the actuary in relation to the Council; • We have assessed the work of the Pension Fund actuary (AON Hewitt), including the assumptions they have used, by relying on the work of PwC – Consulting Actuaries commissioned by PSAA for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and • Reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. <p>Our testing did not identify any material misstatements relating to the valuation of the pension liability.</p>

Financial Statement Audit (continued)

Other Key Findings

Valuation of land and buildings

The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges.

Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

Conclusion

We performed the following testing in relation to this risk:

- We considered the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- We sample tested key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre);
- We 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 reviewed assets not subject to valuation in 2017/18 to confirm that the remaining asset base is not materially misstated;
- We considered changes to useful economic lives as a result of the most recent valuation; and
- We tested accounting entries to ensure they had been correctly processed in the financial statements.

We identified three material misstatements in relation to the valuation of land and buildings that are detailed below:

Valuation of land and buildings

During the audit, we identified the following adjustments that were made to the Council's financial statements:

- £40.8m adjustment to the net book value of Council Dwellings in both the 2016/17 and 2017/18 accounts due to the incorrect inclusion of accumulated depreciation, which should have been removed on revaluation. This impacted upon the Property, Plant and Equipment value disclosed in the Balance Sheet and resulted in the value of the assets increasing, as well as the Comprehensive Income and Expenditure Statement and Unusable Reserves. However, this amendment did not impact upon the Council's General Fund.
- On review of the depreciated replacement cost (DRC) valuations, completed by the Council's valuer, Kier, we identified that the location factor used was higher than we expected. This was queried with Kier who confirmed that the location factor used was incorrect. As a result, a reduction of £5.8m was made to the value of the three DRC valuations included in the Property, Plant and Equipment balance disclosed in the Balance Sheet.
- The Council obtained valuations for both the Feethams Multi Storey Car Park and the Hippodrome. However, the split between land and buildings for both assets was incorrectly added to the fixed asset register which resulted in the revaluation reserve reducing by £14.9m and the value in the Comprehensive Income and Expenditure Statement reducing by £14.9m.

These were all amended and no other issues were identified.

Financial Statement Audit (continued)

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	<p>We determined planning materiality to be £5.2m (2016/17: £5.1m), which is 2% of gross expenditure on the provision of services reported in the accounts.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.257m (2016/17: £0.277m).</p>



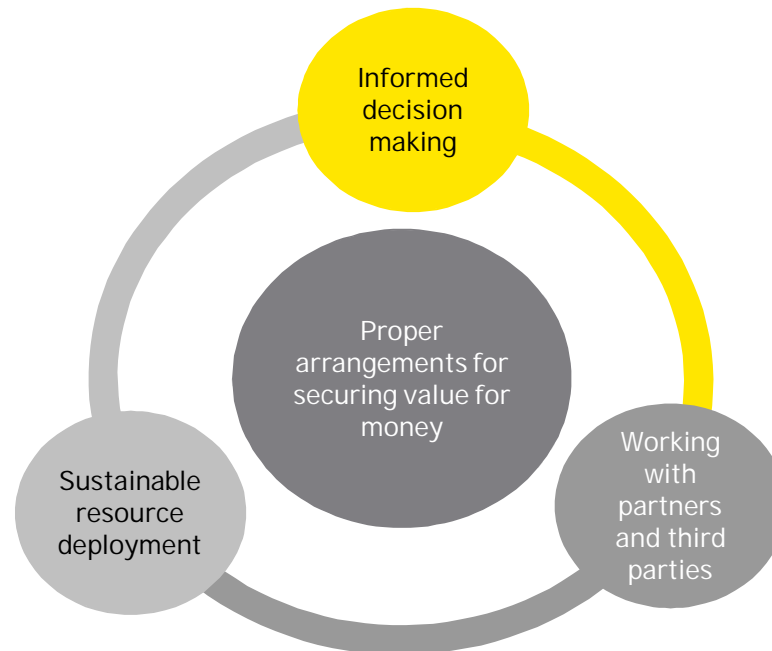
04 Value for Money

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.

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.



Overall conclusion

We identified two significant risks around the value for money arrangements as part of our Audit Planning Report. The table on the following page presents our findings in response to these risks. We did not identify any further significant risks or weaknesses after the audit planning phase.

Based on the work performed we have no matters to report about your arrangements to secure economy, efficiency and effectiveness in the use of resources and issued an unqualified value for money conclusion.

£ Value for Money (continued)

What is the significant value for money risk?

Financial sustainability

The Council faces a challenging set of financial circumstances, resulting from reductions in revenue made available from Central Government and additional budget pressures, including growing demand for services.

The Council has produced a medium term financial plan that ensures it is able to provide all of its statutory services.

However, as a result of further budget reductions and low levels of reserves, there is a risk that an unexpected cost pressure or unforeseen events may result in the Council being unable to deliver this plan.

Children's Services Ofsted Inspection

The Council was subject to an Ofsted review in June and July 2015. This resulted in the Council being provided with an overall "inadequate" rating. The Council, along with external consultants Red Quadrant, have developed an improvement plan to address the issues raised by Ofsted.

Subsequent correspondence from both Ofsted and the Department for Education highlight that improvements have been made, although further improvements are required.

What are our findings?

We completed the following work in this area:

- We obtained a copy of the latest medium term financial plan and tested a sample of the assumptions used;
- We reviewed the 2017/18 outturn report that was presented to Cabinet in June 2018 and assessed whether the medium term financial plan and cost reduction plans are on target;
- We assessed the Council's level of reserves using our financial resilience tools; and
- We selected a sample of cost reduction plans and tested the assumptions used to ensure the savings targets were reasonable.

The testing performed identified that the Council is currently delivering against its medium term financial plan and have reported a £530k improvement in 2017/18 against the projected outturn. Our testing of the assumptions used in the cost reduction plans and medium term financial plan identified that they are reasonable. Based on the testing performed, we were satisfied that there is no impact upon our VFM conclusion from this risk.

We completed the following work in this area:

- We received regular updates from senior officers during the year on the progress that has been made; and
- We reviewed the findings of the Ofsted reports that have been received during the year.

On 21 May 2018, Ofsted confirmed that they would be lifting the "Inadequate" rating and as a result we were satisfied that governance arrangements had improved sufficiently, therefore there was no impact upon our VFM conclusion from this risk.



05 Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

The Council is below the specified audit threshold of £500m. 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 2017/18 financial statements from members of the public.

Other Reporting Issues (continued)

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 26 July 2018. 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.

Control Themes and Observations

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. The impact on the Council is summarised in the table below.

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 is calculated; and • The disclosure requirements for financial assets. <p>There are transitional arrangements within the standard and the 2018/19 Code of Practice on Local Authority Accounting has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA 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. However, what is clear is that the Council will have to:</p> <ul style="list-style-type: none"> • Reclassify existing financial instrument assets; • Re-measure and recalculate potential impairments of those assets; and • Prepare additional disclosure notes for material items.
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 Business Rates 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 Code of Practice on Local Authority Accounting has been issued, the impact on local authority accounting is becoming clear. 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>As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; due to the revenue streams of local authorities, the impact of this standard is likely to be limited.</p> <p>The standard is far more likely to impact on local authority trading companies who will have material revenue streams arising from contracts with customers. The Council will need to consider the impact of this on their own group accounts when that trading company is consolidated.</p>



Focused on Your Future (continued)

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 Code of Practice for Local Authority Accounting 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 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 identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>



07

Audit Fees

Audit Fees

Our fee for 2017/18 is in line with the scale fee set by the PSAA and reported in our 26 July 2018 Audit Results Report.

	Planned fee 2017/18	Scale fee 2017/18	Final fee 2016/17
	£	£	£
Total Fee - Code work	93,264	93,264	93,264
Total Fee - Housing Benefit certification work	8,911	8,911	11,525
Total Audit fee	102,175	102,175	104,789
Non-audit work - Teachers' Pensions Certification	TBC	-	3,200
Non-audit work - Housing Pooling Certification	TBC	-	3,000
Non-audit work - Homes and Communities Agency Rent and Sale Checklist review	TBC	-	5,000
Total fees	102,175	102,175	115,989

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