# Annual Audit Letter

*Year ending 31 March 2018*

Cheshire West and Chester Council

September 2018

# Contents


**Your key Grant Thornton team members are:**

Robin Baker

Engagement Lead

T 44(0)161 214 6399

M 44 (0)788 045 6159

E robin.j.baker@uk.gt.com

Gerard Small

Engagement Manager

T 44(0)161 214 637

M 44(0)788 0 45 6170

E ged.w.small@uk.gt.com

Stuart Basnett

In-Charge Accountant

T: 44(0)151 224 7232

E stuart.h.basnett@uk.gt.com

# Executive Summary

## Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Chester West and Chester Council (the Council) and its subsidiaries (the group) for the year ended 31 March 2018.

The Letter is intended to provide a commentary on the results of our work to the Council and group and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit and Governance Committee as those charged with governance in our Audit Findings Report on 25 July 2018.

## Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council and group's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council and group's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

## Our work

| | |
|---|---|
| **Materiality** | **Financial Statement level materiality**: We determined materiality for the audit of the Council's financial statements to be £13.6 million, which is 1.9**%** of the gross revenue expenditure. We determined materiality for the audit of the pension fund accounts administered by the Council to be £49.8 million which is 1**%** of the pension fund's net assets. This represents the degree of cumulative misstatement at which readers of the financial statements would reach a different conclusion as to the position of the Council and pension fund. |
| | **Performance materiality**: We set a lower level of performance materiality at 75% of our financial statements materiality. This lower threshold enables us to design audit procedures in sufficient detail and with sufficient coverage to minimise the risk of material misstatements not being identified. For the Council  we set our performance materiality at £10.22 million and for the pension fund £37.35 million. |
| | Cle**arly trivial misstatements**: We ask management to correct all misstatements identified through our audit work unless they are clearly trivial in nature. We set the trivial level at 5% of the financial statement level materiality which for the Council was £682,000 and for the pension fund £2.5 million..<br><br>All misstatements above triviality were reported to the Audit and Governance Committee on 25 July 2018. There were three misstatements in the Council's financial statements and all were corrected by management. The misstatements related only to disclosure requirements and had no impact on the reported results of the Council. In the pension fund financial statements there were minor presentational changes and one change to disclose a significant event that occurred after the draft financial statements were presented for audit but which did not affect the reported position of the fund. |
| | **Sensitive items**: Officer remuneration and termination benefits are sensitive items over which stakeholders will expect the Council to take particular care, for these items we set materiality at £20,000; there was no trivial threshold. |
| **Financial Statements opinion** | We gave an unqualified opinion on the Council and group financial statements on 26 July 2018, which is in line with the new earlier reporting deadline. We also gave an unqualified opinion on the pension fund accounts of Cheshire Pension Fund on  26 July 2018. |
| **Whole of Government Accounts (WGA)** | We completed work on the Council's consolidation return following guidance issued by the NAO. |
| **Use of statutory powers** | We did not identify any matters which required us to exercise our additional statutory powers. |

# Executive Summary

| | |
|---|---|
| **Value for Money arrangements** | We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 26 July 2018. |
| **Certification of Grants** | We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2018. We will report the results of this work to the Audit and Governance Committee in our Annual Certification Letter. |
| **Certificate** | We certify that we have completed the audit of the accounts of Cheshire West and Chester Council in accordance with the requirements of the Code of Audit Practice. |

## Working with the Council

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in June and July, delivering the audited accounts 6 days before the deadline
- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports
- Providing training – we provided your teams with training on financial accounts and annual reporting

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

**Grant Thornton UK LLP**
**September 2018**

# Audit of the Accounts

## Our audit approach

### Materiality

In our audit of the Council's and the group's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the group accounts to be £13.8 million, which is 1.9**%** of the group's gross revenue expenditure. We determined materiality for the audit of the Council's accounts to be £13.6 million, which is 1.9**%** of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the group and Council's financial statements are most interested in where the group and Council has spent its revenue in the year.

We set a lower level of specific materiality for senior officer remuneration and termination benefits of £20,000 because stakeholders will be particularly interested in these items. We set a lower threshold of £682,000, above which we reported errors to the Audit and Governance Committee in our Audit Findings Report.

### Pension Fund Materiality

For the audit of the Cheshire Pension Fund accounts, we determined materiality to be £49.8 million, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a threshold of £2.5 million above which we reported errors to the Pensions Committee and the Audit and Governance Committee.

### The scope of our audit

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

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the Statement of Accounts and the narrative report and annual governance statement published alongside the Statement of Accounts to check they are consistent with our understanding of the Council and group and with the financial statements included in the Statement of Accounts on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach is based on a thorough understanding of the Council's and group's business and is risk based. We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

# Audit of the Accounts

## Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Improper revenue recognition**<br>Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. | We considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority, we determined that the risk of fraud arising from revenue recognition can be rebutted, because:<br>• There is little incentive to manipulate revenue recognition<br>• Opportunities to manipulate revenue recognition are very limited<br>• The culture and ethical frameworks of local authorities, including Cheshire West and Chester Council, mean that all forms of fraud are seen as unacceptable. | We did not consider this to be a significant risk for Cheshire West and Chester Council. |
| **Management override of controls**<br>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We identified management override of controls as a risk requiring special audit consideration. | As part of our audit work we have:<br>• reviewed accounting estimates, judgements and decisions made by management<br>• tested of journal entries<br>• reviewed unusual significant transactions<br>• reviewed significant related party transactions outside the normal course of business. | Our audit work did not identify any issues in respect of management override of controls. |

# Audit of the Accounts

## Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Valuation of property, plant and equipment**<br>The Council revalues its land and buildings on an quinquennial basis to ensure that carrying value is not materially different from current value. This represents a significant estimate by management in the financial statements.<br><br>We identified the valuation of land and buildings revaluations and impairments as a risk requiring special audit consideration. | As part of our audit work we have:<br>• Reviewed management's processes and assumptions for the calculation of the estimate.<br>• Reviewed the competence, expertise and objectivity of any management experts used.<br>• Reviewed the instructions issued to valuation experts and the scope of their work<br>• Discussed with the Council's valuer the basis on which the valuation was carried out, challenging the key assumptions.<br>• Reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding.<br>• Tested revaluations made during the year to ensure they were input correctly into the Council's asset register<br>• Evaluated the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value. | The Council's accounting policy for Investment Properties stated that they are reported at fair value at each reporting date, which is in line with the CIPFA Code requirements. However, within the notes to the financial statements it states that Investment Properties are included in the five year rolling programme and assets that have a value greater than £9m or where certain trigger events occur during the year, are added to the list of assets to be formally valued by the valuation team. Not all investment properties are formally valued on a fair value basis every year. The practise was not compliant with the Code.<br>The finance team conducted a retrospective review of this year's valuation programme and concluded that had all assets been revalued the difference would have been -£1.3m and therefore not material. We reviewed this exercise and were satisfied with its findings.<br>Our substantive testing of the Investment Property valuations revealed that a substantial number are low value properties for which regular revaluations might be considered disproportionate. We recommended the Council:<br>• Review its practise for valuing Investment Properties to ensure it complies fully with the Code requirements<br>• Review its Investment Property portfolio and consider if the classification of assets within the portfolio remains appropriate. |

# Audit of the Accounts

## Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Valuation of pension fund net liability**<br>The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements.<br><br>We identified the valuation of the pension fund net liability as a risk requiring special audit consideration. | As part of our audit work we have:<br>• Identified the controls put in place by management to ensure that the pension fund net liability is not materially misstated and assessed whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement.<br>• Review of the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation.<br>• Gaining an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made.<br>• Review of the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary. | Our audit work did not identify any issues in respect of the pension fund net liability |

# Audit of the Accounts

## Pension Fund Significant Audit Risks

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the pension fund.

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Improper revenue recognition**<br>Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. | We considered the risk factors set out in ISA240 and the nature of the revenue streams at the Pension Fund, we determined that the risk of fraud arising from revenue recognition can be rebutted, because:<br>• There is little incentive to manipulate revenue recognition<br>• Opportunities to manipulate revenue recognition are very limited<br>• The culture and ethical frameworks of local authorities, including Cheshire Pension Fund, mean that all forms of fraud are seen as unacceptable. | We did not consider this to be a significant risk for Cheshire Pension Fund. |
| **Management override of controls**<br>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.<br>We identified management override of controls as a risk requiring special audit consideration. | As part of our audit work we have:<br>• reviewed accounting estimates, judgements and decisions made by management<br>• tested of journal entries<br>• reviewed unusual significant transactions<br>• reviewed significant related party transactions outside the normal course of business. | Our audit work did not identify any issues in respect of management override of controls. |

# Audit of the Accounts

## Pension Fund Significant Audit Risks

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the pension fund.

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| Valuation of level 3 investments<br><br>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.<br><br>We identified the valuation of level 3 investments as a risk requiring special audit consideration. | As part of our audit work we have:<br>• updated our understanding of the Fund's process for valuing level 3 investments and evaluated the design of the associated controls<br>• reviewed the nature and basis of estimated values, considered what assurance management had over year end valuations for these types of investment<br>• considered the competence, expertise and objectivity of management experts used<br>• reviewed the qualifications of experts (fund managers & custodian) to value Level 3 investments, and gained an understanding of how the valuation has been reached<br>• tested a sample of investment valuations reflected in financial reporting of the Fund by obtaining the latest available audited accounts of the investee, comparing these to the fund manager reports, and reconciling to known movements between the investee's and the Pension Fund year end dates. | The estimation process was considered appropriate and our testing did not identify any errors. |

# Audit of the Accounts

### Audit opinion

We gave an unqualified opinion on the Council and group's financial statements on 26 July 2018, in advance of the national deadline.

**Preparation of the accounts**

The Council presented us with draft accounts in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

**Issues arising from the audit of the accounts**

We reported the key issues from our audit to the Council's Audit and Governance Committee on 25 July 2018.

In addition to the key audit risks reported above, our audit identified the following matters that management agreed to amend to improve presentation and clarity;

- an additional column was added to the expenditure and funding analysis to explain the difference between the amount charged to services as reported to management and as reported in the general fund,
- additional information was provided on the amount of future lease payments, and
- background information on the group accounts was moved to be included in the notes to the group financial statements.

We also noted that the Council followed different approaches for depreciating leased and purchased assets. The approach for purchased assets was inconsistent with the requirements of the CIPFA Code. Whilst it was unlikely to result in a material error, it could result in repeated errors that were above the clearly trivial threshold. Management therefore accepted our recommendation to review its practice in this area.

**Annual Governance Statement and Narrative Report**

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

**Whole of Government Accounts (WGA)**

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which did not identify any issues for the group auditor to consider.

**Pension fund accounts**

We gave an unqualified opinion on the pension fund accounts of the Cheshire Pension fund on 26 July 2018.

We also reported the key issues from our audit of the pension fund accounts to the Cheshire Pension Fund Committee on 20 July 2018 and to Council's Audit and Governance Committee on 25 July 2018.

In addition to the key audit risks reported above, our review of the draft financial statements identified a small number of minor presentational errors that management agreed to correct.

# Audit of the Accounts

## Other statutory powers

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have not had any reason to exercise theses additional statutory powers.

## Certificate of closure of the audit

We are also required to certify that we have completed the audit of the accounts of Cheshire West and Chester Council in accordance with the requirements of the Code of Audit Practice. This we did on completion of the WGA work.

# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:
*In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

## Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out in detail overleaf.

## Overall Value for Money conclusion

Our work confirmed that the Council has arrangements in place to manage risk on its major projects, has a sound financial footing, and is working effectively with its partners. We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2018.

# Value for Money conclusion

## Key Value for Money Risks

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Financial sustainability**<br>The Council has a strategy of leading high profile re-generation schemes albeit against a background of continued uncertainty about the wider economic outlook.<br>The risks we identified were:<br>• Whether the arrangements were adequate to manage foreseeable risks to the Council.<br>• Whether the Council was able to show that 'normal' activity continued to be managed effectively. | As part of our work we have:<br>• reviewed the Council's strategy documents<br>• considered what management (officer) and member groups oversee major projects<br>• reviewed reporting arrangements and the reports presented to these groups<br>• reviewed budget and outturn reporting | • The Council has a capital strategy that sets out its aims and objectives and provides a framework to ensure all projects support the Council's service priorities. It sets out arrangements for managing and monitoring projects and assessing their value for money. The strategy describes the 'capital journey' (the stages for creation, delivery, and processes for governance and oversight)<br>• There are two key officer groups overseeing capital. One acts as the decision making panel for individual projects and the other ensures that the capital programme is appropriately commercially and investment focused. There are trigger points at which projects can be referred back to previous stages for re-design or re-consideration including referral to the full Council where policy or budget decisions are required.<br>• The Northgate Development and Investment Board and the Baron's Quay Board oversee the projects, meet monthly and provide regular updates to Cabinet. Each project has its own detailed risk register that records risks, mitigations and management actions; it is updated fortnightly. The two projects are progressing broadly in line with plans although volatility in the retail lettings market has had an impact on the timing.<br>• In 2017-18, the Council achieved an underspend of £400k (p/y £1.5m) against a budget of £276.2m (p/y £274.9m), and delivered savings of £10.3m against a target of £12.1m. At 31 March 2018, the un-earmarked general fund stands £24.4m. Any overspends arising during the year were met by non-recurrent savings. The majority of overspends/underspends are managed by re-profiling agreed budgets.<br>• Adult Social Care and Children's Services were particularly pressured as both services experienced increasing demand and complexity.<br>• When Council approved the 2017-18 budget, it also approved a approved a three year budget plan to 2019-20. A funding gap of £33.3m has been identified for the period. Whilst challenging, the Council considers the savings target realistic and achievable.<br>• The Council also continues to work closely with its partners in the NHS |

# A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

### Reports issued

| Report | Date issued |
|---|---|
| Audit Plan | February 2018 |
| Audit Findings Report | July 2018 |
| Annual Audit Letter | September 2018 |

### Fees

| | Planned £ | Actual fees £ | 2016/17 fees £ |
|---|---|---|---|
| Statutory audit of Council and group financial statement | 153,152 | 153152 | 153,152 |
| Audit of Pension Fund | 29,342 | 29,342 | 29,342 |
| Audit Subsidiary Cheshire Provider Services Ltd | 14,000 | TBC | 13950 |
| Audit of Joint Venture Edsential | 18,500 | TBC | 18,000 |
| Audit of Joint venture Cosocius | - | - | 15,000 |
| Housing Benefit Grant Certification | 27,488 | TBC | 27,488 |
| **Total fees** | **£242,482** | **TBC** | **£256,932** |

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA)

### Fees for non-audit services

| Service | Fees £ |
|---|---|
| **Audit related services** | |
| Certification of Teachers Pension Return (proposed) | 1,750 |
| Certification of Housing Capital Receipts Return (proposed) | 2,000 |
| IAS 19 Assurance to other Auditors | 1,964 |
| **Total fees** | **£5,714** |

### Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council and group. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Council and group's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Council and group's policy on the allotment of non-audit work to your auditor.

# B. Recommendations

We have identified 2 recommendations for the Council as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2018/19 audit.

| | Assessment | Issue and risk | Recommendations |
|---|---|---|---|
| 1 | ● | • The Council's accounting policy for Investment Properties states that they valued at fair value at each reporting date. The valuation practise is to include them within the rolling programme on a similar basis to all other property assets with safeguards for assets incurring significant events. This practise does not align with the stated accounting policy and therefore does not comply with the CIPFA Code of Practice on local authority accounting in the UK. | • Review the practise for valuing Investment Properties to ensure it complies fully with the Code requirements.<br>• Review the Investment Property portfolio and consider if the classification of assets within the portfolio remains appropriate.<br><br>**Management response**<br>• The Council is currently undertaking a review of its Investment Property Portfolio through an external company. The findings of this review will be presented to the Strategic Asset Board in September.<br>• Management will review the current policy applying a rolling revaluation programme to Investment Properties once the external review has been completed with the aim of establishing recommendations to alignment with the CIPFA Code of Practice. |
| 2 | ● | • The Council adopts a difference practice for depreciating bought and leased assets. The practice for bought assets is not consistent with the requirements of the Code though it has not resulted in a material difference to the total amount of depreciation charged in the year. | • Review the practise for depreciating bought assets to ensure it complies fully with the Code requirements.<br><br>**Management response**<br>• The current policy of the Council allows for depreciation for Operational Land and Buildings to be reported in the final year of which the asset is of service and not the first. The ability to report accurately in the first year of which capital expenditure is incurred against amount of service usage obtained requires a change in business processes which will be reviewed during the year. |

**Controls**

- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Grant Thornton

grantthornton.co.uk