Ryedale District Council

# Final Report to the Overview and Scrutiny Committee on the 2015 Audit

23 September 2015

# Contents



## A reminder of our audit plan:

- We determined materiality as £407k and a reporting threshold of c.£20k
- We identified 5 significant risks in our Audit Plan and have not made any changes from the scope set out in the Audit Plan.
- We have taken a fully substantive approach to testing the financial statements.

# The big picture

# The big picture

## We anticipate issuing an unmodified audit opinion upon completion of our work.

### Audit work

- We have discussed our initial comments on the draft financial statements with management.
- From our audit work on the financial statements we identified one material misstatements but no significant deficiencies in internal controls at the Council. The misstatement related to a property valuation and resulted in an increase of £750,000 to the valuation of the Council's office buildings which has been adjusted in the financial statements. There were a small number of minor disclosure deficiencies identified which were corrected by management. Two immaterial unadjusted items over our reporting threshold are included in Appendix 1.
- We have undertaken a risk assessment in line with the Audit Commission guidance on assessing the delivery of Value for Money and have concluded that there are no specific risks to the delivery of Value for Money.
- A representation letter will be circulated separately for consideration by management.
- From our work undertaken so far we expect to issue an unmodified opinion in line with your specified deadlines.

We have the following principal matters to complete:

- Report from Pension Scheme auditors to support the valuation of Pension Scheme Assets;
- Finalisation of our Value for Money work;
- Final review and close down procedures;
- Subsequent events review; and
- Receipt of signed letter of representation.

# Significant audit risks

This section explains the nature of significant risks, how these risks have been addressed by our audit work and our conclusions.  We also explain related presentational and/ or disclosure matters within the financial statements.

# Summary of significant audit risks

## Key areas of judgement focused upon during the audit

| Description of the risk | ← | | | | | Acceptable Range | | | | | | → | | Findings |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue Recognition** | Overly cautious and/or likely to future credit | | | | | | ✓ | | | | | | Overly optimistic and/or likely to future debit | G |
| **Management Override of Controls** | | | | | | | ✓ | | | | | | | G |
| **Valuation of PPE** | | | | | ✓ | | | | | | | | | A |
| **Bad Debt Provisioning** | | | | | | | ✓ | | | | | | | G |
| **NNDR Appeals Provision** | | | | | | | ✓ | | | | | | | G |

✓ **Current Year Assessment**

| | | | |
|---|---|---|---|
| G | No issues noted | A | Adjustment identified |
| R | Material unresolved matter | | |

**Preparing financial statements requires management to exercise significant judgement and make reasonable and supported estimates. In many of these areas there is inevitably a range of possible judgements and estimates for management to consider, and we set out above our assessment of where in that range the key judgements lies for the group financial statements. The table above shows, on a range of acceptable outcomes from less conservative to more conservative, where management's key assumptions and valuations relating to significant estimates lie.**

**Our independent assessment of these judgements is outlined in this section.**

# 1. Revenue Recognition

## Revenue recognition is consistent with the Code

### Nature of risk

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition; evaluate which types of revenue, revenue transaction or assertions give rise to such risks.

Our focus for the risk of revenue recognition is the risk in relation to the early recognition of grant income where conditions exist.

### The key judgement areas and their potential impact on the financial statements

Key controls are required to ensure that all grant income, for which the Council is eligible, is recognised appropriately within the period to which it relates. The key judgement is focused upon whether the Council is eligible to recognise relevant grant receipts, and whether the grant conditions have been met.

### Audit work completed to address the significant risk

We have performed testing by selecting a sample of grant income items, confirming that all income has been recognised in line with the prescribed terms of the grant documentation and in line with the provisions of the CIPFA Code 2014/15.

Further to this, we have compared the Council's grant income with that of its local peers, to ensure that all common grant income recognised by peers has also been recognised by the Council, where appropriate.

### Deloitte view

We do not consider there to be evidence of management bias in the revenue recognition policies adopted.

The revenue recognition policies are in line with other Local Government entities and the CIPFA Code.

# 2. Management override of controls

## Management estimates appear reasonable and free from bias

### Nature of risk

International Standards on Auditing requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

### The key judgement areas and their potential impact on the financial statements

Management is in a unique position to perpetrate fraud because of the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Management may override controls through:

- recording fictitious journal entries;
- applying inappropriate judgment;
- omitting, advancing, or delaying recognition of events and transactions;
- engaging in complex transactions that are structured to misrepresent financial position or financial performance;
- omitting disclosure of related parties and transactions; and
- altering records related to significant and unusual transactions.

Management's key judgements involve instances where estimates are required in the absence of definitive evidence, for example the NNDR appeals provision covered elsewhere in this report.

### Audit work completed to address the significant risk

We have performed the following audit procedures:

- reviewed the processes and performed design and implementation work on the controls management have in place;
- used our 'Audit Analytics' software to test a risk focused sample of journals to ensure the appropriateness of journal entries;
- reviewed accounting estimates for evidence of bias;
- review of various committees' minutes; and
- stayed alert to the possibility of significant transactions that are outside the normal course of business for the Council.

### Deloitte view

From our testing we do not consider management's estimates to be unreasonable and nor have we identified any evidence of bias and significant transactions outside the normal course of business.

# 3. Valuation of PPE and Investment Property

## PPE and Investment Property appear to be valued appropriately

### Nature of risk

There has been a clarification of the Code of Practice for 2013/14, the Council is required to revalue property, plant and equipment with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.  Investment properties are required to be carried at fair value at each balance sheet date.

### The key judgement areas and their potential impact on the financial statements

The Council engaged City of York Council to undertake a valuation exercise of land and buildings as at 31 March 2015 on an Existing Use Value, Market Value and Depreciated Replacement Cost value basis in accordance with the Code of Practice.

The key judgements made by management are the adoption of the assumptions made by the valuer.

### Audit work completed to address the significant risk

We have obtained a copy of the latest valuation report.  The valuation resulted in a decrease to investment properties of £340k and a net reduction in operational land and buildings of £365k.  We challenged the assumptions and basis of valuation used by the valuer, by reviewing a sample of valuations in detail.  We found that one property, the Council's offices, had been undervalued by the application of an inappropriate discount tot eh valuation.  An adjustment to increase the valuation by £750,000 has been made in the Statement of Accounts.  We have no other comments on the valuation.  We reviewed the accounting policies in respect of componentisation and consider that these continue to be appropriate.

We have tested the design and implementation of controls management has put in place to ensure land and buildings are materially fairly stated in the balance sheet and we have tested the disclosure of PPE balances in the accounts, particularly with reference to the disclosures of valuation methodologies and the date of valuation.   Since the entire portfolio has been revalued this year, there was no need to consider whether noted impairments should be applied more widely to other assets.

### Deloitte view

Our work in relation to the valuation of non-current assets has been completed. Except for one item, the results of our testing were satisfactory with the valuation exercise being completed in line with the Code of Practice.

One item resulted in an audit adjustment of £750,000 to adjust the valuation of the Council's offices where an inappropriate discount had been applied.

# 4. Calculation of bad debt provision against debtors

## The bad debt provision appears reasonable

### Nature of risk

In the current climate there is likely to be more pressure on the Council's rate-payers' financial resources. Therefore, it follows that there is likely to be a higher level of unpaid debts at the balance sheet date and, potentially, more bad and/or doubtful debts occurring.

### The key judgement areas and their potential impact on the financial statements

The following provisions are included in the financial statements:

| | | |
|---|---|---|
| Sundry debtors | £86,000 | 47% of balance (2014: 47%) |
| Housing benefit | £301,000 | 59.5% of balance (2014: 57%) |
| Council tax/NNDR arrears | £62,000 | |
| Total | £449,000 | |

### Audit work completed to address the significant risk

We have challenged management's methodologies and assumptions used to calculate the bad debt provision and the evidence to support the approach.

We have considered whether provisions appropriately reflect the impact of the changing economic conditions and welfare reforms by reference to recent collection performance and trends.

We have tested the integrity of the ageing data which the Council uses to profile debtors by age, to confirm that the base data which is provided against is accurate.

### Deloitte view

From our testing we do not consider management's provisions against bad debt to be unreasonable and have not identified any non-compliance with the Code.

# 5. Completeness of NNDR appeal provisions

## Provisions for NNDR appeals have a rational basis of calculation

### Nature of risk

From our initial inquiries, we understand a number of significant business ratepayers have appealed against the ratings provided by the Valuation Office Agency (VOA).

The Council entered a risk pooling arrangement for NNDR with a number of North Yorkshire councils from 1 April 2014. The risk pooling arrangement does not impact the provision to be recognised by the Council each year, rather it realises a surplus or deficit for pool participants based on actual settlements in any given year.

### The key judgement areas and their potential impact on the financial statements

The full value of the NNDR appeals provision is £1,390,000, of which 40% is the Council's proportion, being £556,000.

The underlying assumption is an appeal success rate of 4.3% based on past experience. Two atypical properties are provided for on specific bases following management's discussions with appeals officers and experts.

### Audit work completed to address the significant risk

We have challenged management's methodologies and assumptions used to calculate the appeals provision and the evidence to support the approach, and considered whether provisions appropriately reflect the historical trends for NNDR claims of this nature.

We have reviewed VOA data and trends, in order to formulate a best-estimate of the provision and use this to determine whether management's approach is reasonable.

### Deloitte view

From our testing we do not consider management's provisions against NNDR appeals to be unreasonable and have not identified any non-compliance with the Code.

# Value for Money and the Annual Governance Statement

# Value for Money Conclusion

## Requirement

Under the Audit Commission Code of Audit practice, as appointed auditors, we are required to draw a conclusion regarding the Council's arrangements to secure economy, efficiency and effectiveness of its use of resources (the Value For Money (VFM) conclusion). As was the case in previous years, we will have regard to the specified criteria, published by the Audit Commission, as to whether the Council has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

## Audit work completed

We have reviewed the risk assessments for the savings proposals in the 2015/16 budget and arrangements for the on-going management of those risks. Progress in developing the budget for 2016/17 is on-going with the next meeting expected to be in November to discuss planned budget savings. Whilst the Council has coped well with previous government funding cuts, the anticipated future reductions in funding from 2015/16 onwards will be a significant challenge involving difficult decisions around resource prioritisation.

During the course of this work, we have considered the effectiveness of arrangements to assess the implications of savings measures and to manage their impact on the delivery of strategic priorities. In particular, we have considered the outcome, in July 2015, of the Judicial Review of the Wentworth Street car park planning decision and do not consider this to represent is significant risk to the Value For Money conclusion. We note the action taken by the Council to engage KPMG to review the outcome of the Judicial Review and recommend that the Council take steps to address any recommendations arising from that review to strengthen their governance arrangements in the area of planning.

We completed our risk assessment and concluded that there were no specific risks to the Value for Money conclusion for 2014/15 and, as a consequence, have not undertaken any locally determined risk based work.

We have considered the results of our work on the Annual Governance Statement, the results of our audit work and the findings of internal audit.

### The VfM Conclusion

Under the Code, auditors are required to include a positive conclusion in their statutory audit report as to whether they are satisfied that, in all significant respects, the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The conclusion has regard to the criteria specified by the Commission and we do not consider all aspects of the Council's arrangements. This conclusion is given within our audit report on the Council's accounts. We are required to report if, in our judgement, matters come to our attention which are significant enough to prevent us from concluding that proper arrangements are in place in the areas considered. In such a circumstance, we qualify our conclusion in relation to particular criteria, either on an 'except for' basis (i.e. the Council has put in place proper arrangements except for…) or in the form of an 'adverse' conclusion (i.e. the Council has not put in place arrangements in that…).

For 2014/15, as at the time of writing this report, we have assessed the Council for both the financial resilience and the economy, efficiency and effectiveness criteria as having proper arrangements in place. We will update on this verbally at our meeting on 23 September 2015 and confirm whether we will be issuing an unqualified conclusion, as is currently anticipated. The format of our opinion can be found in the Statement of Accounts which will be presented separately at that meeting.

**Deloitte view:** Based on our findings to date we anticipate providing a positive conclusion on the Council's Value for Money arrangements.

# Insight - Internal control and risk management

**In this section we set out our comments regarding your internal control and risk management processes. We communicate any significant deficiencies in the internal control environment to the Overview and Scrutiny Committee.**

# Internal control and risk management

## We highlight one observation from our audit procedures

| Area | Observation/Finding | Recommendation | Management Comment |
|---|---|---|---|
| Asset disposals | Three small pieces of land, with an asset register valuation of £230,000 (2014: £240,000), appear to have been marketed for sale during the year without a documented record of the disposal process.<br><br>The items were marketed at a total value of £165,000, being £65,000 lower than the asset register valuation, and potentially at under-value.<br><br>Further enquiry indicates that the items have not received any serious offers to date and therefore the asset register value appears to be overstated as noted in Appendix 1. However, the lack of documented record of the disposal process could have resulted in lost sales revenue since the asset register value would have indicated an initial marketing value of £240,000. | Ensure a formalised document is used to authorise asset sales, including sales value and subsequent price changes. | We will review the process around asset disposals and introduce formal documentation to monitor the process from start to finish. |
| Procurement management oversight regarding order processing and conflicts of interest | During the year it became apparent that orders were being split and processed below certain authorisation limits. Furthermore, conflicts of interest for certain members of management were not recorded or reviewed. | We recommend implementing some data analytics on purchase orders to test for items close to authorisation thresholds (also known as Benford testing) and for recurring items linking the same staff and suppliers which may suggest patterns of procurement.<br><br>Whilst it is difficult to ascertain all conflicts of interest, we recommend that an annual risk-based review of suppliers is performed, specifically aimed at identifying potential conflicts of interest. | Management have introduced procedures, in line with the recommendation, to report on Officer patterns of procurement.<br><br>Practically, this will be restricted to a review against Companies House records. It is likely that the Facilities function will be outsourced, which will significantly reduce the risk from this issue going forward. |

# Responsibility Statement

# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to help the Overview and Scrutiny Committee and the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Governance Statement;
- Our views on the effectiveness of your system of internal control relevant to risks that may affect financial reporting; and
- Other insights we have identified from our audit.

### What we don't report

- As you will be aware, our audit was not designed to identify all matters that may be relevant to the Council.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements.

### The scope of our work

- Our observations are developed in the context of our audit of the financial statements.
- We described the scope of our work in our audit plan dated 7 April 2015 and the supplementary "Briefing on audit matters" which was circulated as an appendix to the Audit Plan.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP

**Deloitte LLP**

Chartered Accountants

Leeds

14 September 2015

This report has been prepared for the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

# Appendices

# Appendix 1: Audit adjustments

## Unadjusted misstatements detail

### Uncorrected misstatements

The following uncorrected misstatements (above reportable threshold of £20,350) were identified during the course of our audit. We will obtain written representations from the Audit, Governance and Standards Committee confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the financial statements taken as a whole, no adjustments are required.

| | Comprehensive income and expenditure statement | | Reserves | Balance sheet |
|---|---|---|---|---|
| | (Credit)/ charge to deficit on provision of services £ | (Credit)/ charge to other comprehensive income £ | Brought forward reserves £ | Increase/ (decrease) in net assets £ |
| **Factual misstatements** | | | | |
| Unaccrued asset for assets acquired under finance lease on 31/03/2015. | - | - | - | 109,000 |
| Unaccrued liability for assets acquired under finance lease on 31/03/2015. | - | - | - | (109,000) |
| Impairment in asset held for sale as the recorded balance per accounts exceeds advertised sales price as per estate agent. | 65,000 | - | - | (65,000) |
| **Total uncorrected misstatements relating to current year items** | **65,000** | **-** | **-** | **(65,000)** |

No disclosure misstatements are noted.

# Appendix 2: Fraud - responsibilities and representations

| | |
|---|---|
| **Required representations** | We have asked the Committee to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity. |
| **Concerns** | No concerns have been identified from whistle blowing procedures from the work noted above and our audit procedures. |
| **Audit work performed** | In our planning we identified the risk of fraud in revenue recognition and management override of controls as key audit risks for your organisation.<br><br>During course of our audit, we have had discussions with management and those charged with governance. We have made direct enquiries in relation to any fraud risk factors and instances of fraud during the year. Our testing of journals provides comfort over the risk of management override of controls which was raised as a fraud risk.<br>In addition, we have reviewed management's own documented procedures regarding the fraud and error in the financial statements. |

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

# Appendix 3: Independence and fees

As part of our obligations under International Standards on Auditing (UK and Ireland), we are required to report to you on the matters listed below:

| | |
|---|---|
| **Independence confirmation** | We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised. |
| **Fees** | The fees have not varied from those set out in our audit plan. The fees payable for grant claims and returns will be confirmed once the Housing Benefit subsidy return is completed in November 2015.<br>For the avoidance of doubt, the only non-audit fees were £2,000 in September 2014 where we performed a certification under the Homes & Communities Agency requirements. |
| **Non-audit services** | In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the Council's policy for the supply of non-audit services or of any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary. |
| **Relationships** | There are no other relationships with Ryedale District Council which would impact on our objectivity and independence. |

# Appendix 4: Our approach to audit quality

## Our commitment to audit quality

**AQR public reporting**

In May 2015 the Financial Reporting Council's ("FRC") issued its Annual Report which provides an overview of the audit quality inspection activities of its Audit Quality Review ("AQR") for the year ended 31 March 2015. It also issued individual reports on each of the four largest firms, including Deloitte. The AQR is part of the Financial Reporting Council, the UK's independent regulator responsible for promoting confidence in corporate reporting and governance. The AQR is responsible for monitoring the audits of all listed and other public interest entities. The AQR currently inspects the four largest audit firms, including Deloitte, annually.

All the AQR public reports on individual firms are available on its website **http://www.frc.org.uk/Our-Work/Conduct/Audit-Quality-Review/Audit-firm-specific-reports.aspx** as is their Annual Report **http://www.frc.org.uk/Our-Work/Conduct/Audit-Quality-Review/Audit-Quality-Review-annual-reports.aspx**.

**AQR comments on Deloitte**

Deloitte's policies and processes supporting audit quality were reviewed as were 20 individual audits. The AQR's conclusion on Deloitte was as follows:

"The firm places considerable emphasis on its overall systems of quality control and, in most areas, has appropriate policies and procedures in place for its size and the nature of its client base. Nevertheless, we have identified certain areas where improvements are required to those policies and procedures. These are set out in this report. Our findings relating to reviews of individual audits largely relate to the application of the firm's procedures by audit personnel, whose work and judgments ultimately determine the quality of individual audits. The firm took a number of steps in response to our prior year findings to achieve improvements in audit quality. This included enhanced guidance, technical communications and audit training on the recurring themes. Certain aspects of the guidance could, however, have been issued on a more timely basis."

**2014/15 Audit Quality Inspection Report on Deloitte LLP**

"Our assessment of the audit work we inspected in 2014/15 continues the gradual improvement of prior years with 67% of those audits assessed as either good or only requiring limited improvements. This compares with 60%, 59%, 46% and 48% in each of the preceding four years.

Audits assessed as requiring limited improvements is the most common categorisation and has been for the last three inspection periods. In the two preceding periods, the lower categorisation of improvements required, was the more common assessment.

In respect of ten audits, we concluded that the audit work we inspected required significant improvements. This represented 10% of the audits we inspected in 2014/15, an improvement on three of the four preceding inspection periods. The proportion of FTSE 350 audits requiring significant improvements was lower at only 6%. This is consistent with our general view that FTSE 350 audit work we inspect is of a higher standard than that of other audits."

**AQR, 2014/15 Annual Report**

"Audit is an integral part of the reporting process that ensures that investors have confidence in the information they receive on the performance of the companies they invest in.

We were pleased that firms responded positively to the new extended auditor reporting requirements. We hope to see further improvements in the clarity of reporting by auditors of how they have addressed the assessed risks. We also expect auditors to discuss findings from our inspections with audit committees and will monitor closely how companies report our findings to their shareholders."

**Paul George, Executive Director, Conduct**