

# Fareham Borough Council

## Audit and Governance Committee Summary

For the year ended 31 March 2015

Audit Results Report – ISA (UK and Ireland) 260

September 2015



Building a better  
working world

# Contents

|           |  | <b>Page</b> |
|-----------|--|-------------|
| Section 1 | Executive summary  | 2           |
| Section 2 | Extent and purpose of our work                               | 4           |
| Section 3 | Addressing audit risks                                       | 6           |
| Section 4 | Financial statements audit – issues and findings             | 8           |
| Section 5 | Arrangements to secure economy, efficiency and effectiveness | 12          |
| Section 6 | Independence and audit fees                                  | 16          |

**Section 1**

# **Executive summary**

# Executive summary – key findings

## Audit results and other key matters

The Audit Commission's Code of Audit Practice (the Code) requires us to report to those charged with governance – the **Audit and Governance Committee** – on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified. This report summarises the findings from the 2014/15 audit which is substantially complete. It includes the messages arising from our audit of your financial statements and the results of the work we have undertaken to assess your arrangements to secure value for money in your use of resources.

### Financial statements

- ▶ As of 7 September 2015, we expect to issue an unqualified opinion on the financial statements. Our audit results demonstrate, through the few matters we have to communicate, that the Council has prepared its financial statements adequately.

### Value for money

- ▶ We expect to conclude that you have made appropriate arrangements to secure economy, efficiency and effectiveness in your use of resources.

### Whole of Government Accounts

- ▶ As at 7 September 2015, we do not expect to report any significant matters to the National Audit Office (NAO) regarding the Whole of Government Accounts submission.

### Audit certificate

- ▶ The audit certificate is issued to demonstrate that the full requirements of the Audit Commission's Code of Audit Practice have been discharged for the relevant audit year. We expect to issue the audit certificate at the same time as the audit opinion.

**Section 2**

# **Extent and purpose of our work**

# Extent and purpose of our work

## The Council's responsibilities

- ▶ The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes 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.

## Purpose of our work

- ▶ Our audit was designed to:
  - ▶ Express an opinion on the 2014/15 financial statements and the consistency of other information published with them
  - ▶ Report on an exception basis on the Annual Governance Statement
  - ▶ Consider and report any matters that prevent us being satisfied that the Council had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the Value for Money conclusion)
  - ▶ Discharge the powers and duties set out in the Audit Commission Act 1998 and the Code of Audit Practice

In addition, this report contains our findings related to the areas of audit emphasis and any views on significant deficiencies in internal control or the Council's accounting policies and key judgments.

As a component auditor, we also follow the NAO group instructions and report the results on completion of the WGA work through the Assurance Statement to the NAO and to the Council.

This report is intended solely for the information and use of the Council. It is not intended to be and should not be used by anyone other than the specified party.

**Section 3**

# **Addressing audit risks**

# Addressing audit risks – significant audit risks

We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the audit of the financial statements is an inherent risk with both a higher likelihood of occurrence and a higher magnitude of effect should it occur and which requires special audit consideration. For significant risks, we obtain an understanding of the entity's controls relevant to each risk and assess the design and implementation of the relevant controls.

| Audit risk identified within our audit plan  | Audit procedures performed   | Assurance gained and issues arising  |
|--|--|--|
| <b>Risk of management override</b>   |  |  |
| <p>As identified in ISA (UK and Ireland) 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.</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 significant unusual transactions</li> </ul>  | <p>All our planned procedures are complete. There are no findings that indicate a risk of misstatement due to fraud or error.</p>  |
| <b>Daedalus airfield valuation</b>   |  |  |
| <p>In March 2015, the Council purchased the freehold of the site from the Homes and Communities Agency (HCA). The site includes: commercial property, infrastructure and specialist assets such as the control tower. The valuation of this asset will require careful consideration. The Council will need to componentise the site and allocate assets between those that are operational and under construction. Operational assets will require valuation for which the Council may require specialist advice.</p> | <p>Our financial statements audit approach will focus on:</p> <ul style="list-style-type: none"> <li>➤ Evaluating the Council's process for allocating individual assets between operational and assets under construction;</li> <li>➤ Evaluating the competence and capability of the Council's valuer;</li> <li>➤ Considering the data provided to the valuer and evaluating the nature and scope of the valuers work;</li> <li>➤ Evaluating the appropriateness of the valuers work as a source of audit evidence.</li> </ul> | <p>We have evaluated the Council's process for allocating assets between operational and assets under construction. We identified no issues.</p> <p>We are satisfied that the Council's valuer is competent and capable.</p> <p>We are finalising our evaluation of the data provided to and assumptions made by your valuer. We will give you a verbal update at the Committee.</p> |



Section 4

# Financial statements audit – issues and findings

# Financial statements audit – issues and misstatements arising from the audit

## Progress of our audit

- ▶ The following areas of our work programme remain to be completed. We will provide an update of progress at the Audit and Governance Committee meeting:
  - ▶ Receipt of a Letter of Representation
  - ▶ Final review and sign off
  - ▶ One investment confirmation from a bank
  - ▶ Reviewing the data provided to and assumptions made by your valuer for the Daedalus valuation
  - ▶ WGA procedures
- ▶ Subject to the satisfactory resolution of the above items, we propose to issue an unqualified audit report on the financial statements.

## Uncorrected misstatements

- ▶ We have identified no misstatement within the draft financial statements, which management has chosen not to adjust.

## Corrected misstatements

- ▶ Our audit identified a few minor misstatements which our team have highlighted to management for amendment. These have been corrected during the course of our work. None were significant enough to need to be brought to your attention.

## Other matters

- ▶ As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process including the following:
  - ▶ Qualitative aspects of your accounting practices; estimates and disclosures;
  - ▶ Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions;
  - ▶ Any significant difficulties encountered during the audit; and
  - ▶ Other audit matters of governance interest

We have no matters we wish to report.

# Financial statements audit – application of materiality

## 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                                     |   |
|--|---|
| Planning Materiality and Tolerable error | <p>We determined planning materiality to be £1.2 million (2014: £1.2 million), which is 2% of gross expenditure reported in the accounts adjusted for the revaluation of HRA properties</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Authority.</p> <p>We set a tolerable error for the audit. Tolerable error is the application of planning materiality at the individual account or balance level. It is set to reduce, to an appropriately low level, the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality. The level of tolerable error drives the extent of detailed audit testing required to support our opinion.</p> <p>We have set tolerable error at the upper level of the available range because there were no corrected significant errors that affected the primary statements in the Authority's 2014/15 financial statements and no uncorrected errors.</p> |
| Reporting Threshold                      | We have reported all unadjusted audit differences in excess of £61,000 (2014: £58,565)  |

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

# Financial statements audit – internal control, written representations and whole of government accounts

## Internal control

- ▶ It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.
- ▶ We have tested the controls of the Council only to the extent necessary for us to complete our audit. We are not expressing an opinion on the overall effectiveness of internal control.
- ▶ We have reviewed the Annual Governance Statement and can confirm that:
  - ▶ It complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
  - ▶ It is consistent with other information that we are aware of from our audit of the financial statements.
- ▶ 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.

## Request for written representations

- ▶ We have requested a management representation letter to gain management's confirmation in relation to a number of matters.

## Whole of Government Accounts

- ▶ Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.

**Section 5**

# **Arrangements to secure economy, efficiency and effectiveness**

# Arrangements to secure economy, efficiency and effectiveness

The Code of Audit Practice (2010) sets out our responsibility to satisfy ourselves that Fareham Borough Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In examining the Council's corporate performance management and financial management arrangements, we have regard to the following criteria and focus specified by the Audit Commission.

## Criteria 1 – arrangements for securing financial resilience

- ▶ 'Whether the Council has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future'
- ▶ In our audit plan we identified one risk in relation to this criteria
  - ▶ The acquisition of Daedalus airfield.
- ▶ Financial pressures in the public sector continue to mount. As a result of these significant pressures there is increased focus on the financial resilience of Local Government. Fareham Borough Council has a good track record of managing its finances and our previous reviews have highlighted no concerns in this area. However, because of these significant pressures we decided that we should highlight this area as a significant risk, explain the work we have undertaken and report our current conclusions to you.
  - ▶ As a result we have included 'Medium Term Financial Planning' as a further significant risk in this report.
- ▶ Our work and conclusions are set out on the next slide

## Criteria 2 – arrangements for securing economy, efficiency and effectiveness

- ▶ 'Whether the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity'
- ▶ In our audit plan we identified one risk in relation to this criteria
  - ▶ The acquisition of Daedalus airfield.
- ▶ We have no issues to report in relation to this criteria
- ▶ Our work did not identify any other matters relating to aspects of your corporate performance and financial management framework which are not covered by the scope of the two specified criteria above.

# Addressing audit risks – significant VFM risks

We identified the following VFM risks during the continuous planning of our audit. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the value for money conclusion is the risk that the auditor may issue the wrong value for money conclusion. Where auditors identify a significant value for money conclusion risk they will need to undertake additional audit work to enable them to reach an appropriate conclusion. We set out below the significant risks we identified in our plan, the procedures performed in response, and our conclusion

## Significant VFM risk– financial resilience and arrangements for securing economy, efficiency and effectiveness - acquisition of Daedalus airfield

| Risk identified  | Procedures undertaken  | Basis for conclusion  |
|--|--|---|
| <p>➤ In March 2015, the Council purchased the freehold of the site from the Homes and Communities Agency (HCA) to facilitate economic development. The Council is now responsible for all operational and financial matters relating to the airfield which it considers viable, although it is projecting short term revenue losses. The Council is planning £10m - £15m capital expenditure to stimulate economic redevelopment on the site. Funding for the capital elements of the project are expected to be a combination of: HCA grant, land sales, prudential borrowing and business rates retention (subject to agreement with the Local Enterprise Partnership). The revenue budget and sources of capital funding are dependent on many assumptions which could have a significant impact on the Council's financial resilience.</p> | <p>Our approach focussed on:</p> <ul style="list-style-type: none"> <li>▶ considering the results of the Council's market analysis study as key to the success of the site will be interest from companies to locate themselves at Daedalus.</li> <li>▶ reviewing the evidence to support the assumptions in the Council's long term financial model for the site and considering if it is consistent with the Council's wider budgeting;</li> </ul> | <p>This long term project does expose the Council to risk around demand from businesses to occupy plots on the site. This is a key significant assumption in the Council's long term financial model. The Council's market analysis study indicated that the assumptions made on the likely take up from businesses are reasonable.</p> <p>The Council presented its 'Daedalus Vision and Strategy' in July 2015 which included an objective to ensure the airfield operates on a break even basis by 2019. Work supporting this objective is underway. The Council has secured funding of around £1.7m against revenue losses over the next three years. This is sufficient to cover the Council's projected losses in the transitional period, and will protect it's financial resilience while the Daedalus Vision and Strategy is implemented.</p> <p>We will revisit this risk in 2015/16 and consider progress in this area once full integration into the Council's revenue and capital budgets is achieved.</p> |

# Addressing audit risks – significant VFM risks cont.

Financial pressures in the public sector continue to mount. As a result of these significant pressures there is increased focus on the financial resilience of Local Government. Fareham Borough Council has a good track record of managing its finances and our previous reviews have highlighted no concerns in this area. However, because of these significant pressures we decided that we should highlight this area as a significant risk, explain the work we have undertaken and report our current conclusions to you.

## Significant VFM risk– financial resilience - Medium Term Financial Planning

| Risk identified  | Procedures undertaken   | Basis for conclusion   |
|--|---|--|
| <ul style="list-style-type: none"> <li>➤ The local government sector continues to face financial challenge; with reductions in central government funding needing to be offset by efficiency plans.</li> </ul> | <p>Our approach focussed on:</p> <ul style="list-style-type: none"> <li>▶ Reviewing achievement against the 2014/15 budget</li> </ul>   | <p>The Council's reported an underspend against its revised budget in 2014/15 of £309,356. The Council has also maintained its reserves at a prudent level. This is despite the financial challenges faced by the local government sector, and not having raised Council Tax since 2009/10.</p>  |
| <ul style="list-style-type: none"> <li>➤ The Council's 5 year Finance Strategy identifies spending and funding pressures and seeks to address them with efficiency savings</li> </ul>                          | <ul style="list-style-type: none"> <li>▶ Reviewing the reasonableness of the assumptions made in the 2015/16 budget and 5 year Finance Strategy</li> <li>▶ Understanding the progress made with and achievability of the efficiency plan</li> </ul> | <p>We have reviewed the assumptions in the 5 year Finance Strategy and the Council's 2015/16 budget and consider them reasonable. However, the Council recognises the uncertainty in future funding levels, in particular from central government, and will need to incorporate the outcome of the Spending Review into future plans.</p> <p>The Council's 5 year Finance Strategy was updated in October 2014 and includes an efficiency plan. The Council has a sound record for delivering efficiency plans. Individual schemes underpinning the plan are either implemented or in progress for all required efficiencies. The Council has a history of achieving savings in advance of need.</p> |



**Section 6**

# **Independence and audit fees**

# Independence and audit fees

## Independence

- ▶ We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan dated 20 April 2015.
- ▶ We complied with the Auditing Practices Board's Ethical Standards for Auditors and the requirements of the Audit Commission's Code and Standing Guidance. 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 of regulatory and professional requirements.
- ▶ We confirm that we are not aware of any relationships that may affect the independence and objectivity of the firm that we are required by auditing and ethical standards to report to you.
- ▶ We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Audit and Governance Committee on 21 September 2015.

- ▶ We confirm that we have met the reporting requirements to the Audit and Governance Committee, as 'those charged with governance' under International Standards on Auditing (UK and Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements were set out in our Audit Plan of 20 April 2015.

## Audit fees

- ▶ The table below sets out the scale fee and our final proposed audit fees.

|  | Proposed final<br>fee 2014/2015 | Scale fee<br>2014/2015 | Variation<br>comments |
|--|---------------------------------|------------------------|-----------------------|
|  | £                               | £                      |                       |
| Audit Fee: Code<br>work                | 64,307                          | 64,307                 | N/A                   |
| Certification of<br>claims and returns | 15,080                          | 15,080                 | N/A                   |
| Non-Audit work                         | Nil                             | Nil                    | N/A                   |

- ▶ Our actual fee is in line with the agreed fee at this point in time, subject to the satisfactory clearance of the outstanding audit work.
- ▶ We confirm that we have not undertaken any non-audit work outside of the Audit Commission's Audit Code requirements.

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ED None

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