Hampshire County Council

Audit Committee Summary

For the year ended 31 March 2015

Audit Results Report – ISA (UK & Ireland) 260

24 September 2015

Building a better
working world

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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 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 the Council's financial statements and the results of our work to assess its arrangements to secure value for money in its use of resources.

Financial statements

- As of 14 September 2015, there are a number of audit procedures that are outstanding, subject to the satisfactory clearance of these procedures we anticipate issuing an unqualified opinion on the financial statements.

Value for money

- Our work is substantially complete in this area and 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 (WGA)

- We are required to issue an opinion to the National Audit Office (NAO) regarding the WGA submission. We will form our conclusion on the opinion we will issue once our outstanding audit procedures are complete.

Audit certificate

- The audit certificate is issued to demonstrate that the full requirements of the Code have been discharged for the relevant audit year. We expect to issue the 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 (AGS). In the AGS, 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 any planned changes in the coming period.
- The Council is also responsible for having 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 proper arrangements for securing economy, efficiency and effectiveness in its use of resources (the Value for Money conclusion); and
  - discharge the powers and duties set out in the Audit Commission Act 1998 and the Code of Audit Practice.

This report also 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.

The Council is considered a component of the Whole of Government Accounts (for the whole public sector) and 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 both 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.

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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 in our Audit Plan. We set out here how we have gained audit assurance over these issues.

In the context of auditing the financial statements, we define a significant audit risk as an inherent risk which is both more likely to happen and has a more serious effect if it does happen, and which requires special audit consideration. For significant risks, we obtain an understanding of the entity's relevant controls and assess their design and implementation.

Audit risk identified within our audit plan	Audit procedures performed	Assurance gained and issues arising
Significant audit risks (including fraud risk)		
Risk of management override 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.	Our approach focused on: ► testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; ► reviewing accounting estimates for evidence of management bias, and ► evaluating the business rationale for significant unusual transactions.	We found no issues of concern in these areas.
Accounting for schools' non-current assets The 2015 Accounting Code confirms that local authority maintained schools (community, voluntary aided, voluntary controlled and foundation) should be treated as entities for financial reporting purposes in accordance with IFRS 10, and adapts the definition of single entity financial statements so that schools are consolidated into these statements. In December 2014, CIPFA/LASAAC issued 'LAAP Bulletin 101 Accounting for Non-Current Assets Used by Local Authority Maintained Schools' providing guidance on the application of the Accounting Code to non-current assets. This, particularly focused on Voluntary Aided (VA), Voluntary Controlled (VC), and some foundation schools where non-current assets are owned by a third party. Despite the changes to the Accounting Code and the additional guidance included in LAAP Bulletin 101, there remains the potential for different interpretations of how non-current school assets are accounted for in 2014/15	Our approach will focused on: ► confirming that the Council had not applied a 'blanket' approach to recognition, but had considered the nature of the agreements in place locally when determining their accounting approach; ► ensuring that the Council correctly applied the relevant accounting standards (IAS16) to the non-current assets for each category of schools; ► reviewing documentation and evidence to support the accounting treatment adopted; and ► ensuring appropriate disclosures of the judgments and accounting policies applied to schools' assets.	We found no issues of concern in these areas.

Section 4

Financial statements audit – issues and findings

Financial statements audit – issues and misstatements arising from the audit

Progress of our audit

- We still have some procedures to complete in the following areas of our work programme. We will provide an update of progress at the Audit Committee meeting:
  - Accounts payable;
  - Financial instruments;
  - Provisions;
  - receipt of a Letter of Representation; and
  - Completion of our review and conclusion procedures.

- Subject to the satisfactory clearance of these procedures we anticipate issuing an unqualified opinion on the financial statements.

Uncorrected misstatements

- We have identified no misstatements to date in the draft financial statements which management has chosen not to adjust.

Corrected misstatements

- To date our audit has identified a few errors which have been highlighted to management for amendment. Management have agreed to correct these errors.

Other matters

- As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must communicate to the Committee significant findings from the audit and other matters significant to the oversight of the Council's financial reporting process. These include the following:
  - qualitative aspects of accounting practices; estimates and disclosures;
  - matters specifically required by other auditing standards to be communicated to those charged with governance, e.g. issues around fraud, compliance with laws and regulations, external confirmations, and related party transactions;
  - any significant difficulties during the audit; and
  - any other audit matters of governance interest.

We would like to draw the Committee's attention to the following areas:

- The annual completion of related party transaction declarations, by Members, is an important process via which the Council can demonstrate and ensure the probity of transactions. As at 14 September officers had not received the required declarations from three Members.
- The accounts presented for audit reported a 3,333 (15%) increase in the number of Council employees in the pension scheme. On review management identified that this figure was overstated by approximately 1,300 due to a back log of leaver forms which were not sent to the Pension Services team for processing. Whilst the details on the Council's payroll were correct, it is important that the pension administration system is properly maintained. Action is being taken to address this issue.

Looking ahead to the early accounts closedown timetable in 2017/18, we have noted areas for joint action where improvements can be made to the audit process, we will liaise with Management to identify the lessons to be learnt in order to secure improvement for the 2015/16 audit.

Financial statements audit – application of materiality

Our application of materiality

- When establishing our overall audit strategy, we set the level of uncorrected misstatements we considered to be material for the financial statements as a whole.

Item	
Planning Materiality and Tolerable error	We determined planning materiality to be £20.3 million (2014: £40.6 million). We outlined in our audit planning report that the reduction in materiality from the prior year is because we have now classed the Council as a public interest entity and as result we calculated it on 1% of gross expenditure as opposed to the 2% which was used in the prior year. Gross expenditure of £1.88 billion as reported the accounts adjusted for £7 million loss on disposal of assets and £142 million financing costs. We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council. We also set a tolerable error (TE) for the audit. This is how we apply planning materiality at the more detailed level of an individual account or balance. Its purpose is to make reasonably sure that the total of all uncorrected and undetected misstatements is unlikely to exceed planning materiality. The level of TE drives how much detailed audit testing we need to support our opinion. We set TE at the upper level of the available range as we assessed the risk of mistatements to be low, because in 2013/14 there were no uncorrected errors and no material or significant corrected errors
Reporting Threshold	We agreed with the Audit and Standards Committee that we would report all audit differences in excess of £1.014 million (2014: £2.03 million). On receipt of the draft statement of accounts our reporting threshold was increased to £1.015 million.

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

Internal control

- It is the Council's responsibility to develop and implement systems of internal financial control and to have proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as the Council's auditor is to consider whether the Council has adequate arrangements to satisfy itself that this is indeed the case.
- We have assessed the controls of the Council only to the extent needed to complete our audit. We are not expressing an opinion on the overall effectiveness of internal control.
- We have not identified any significant deficiencies in the design or operation of an internal control, which the Council does not know about, that might result in a material misstatement in the financial statements.
- We have reviewed the Annual Governance Statement (AGS) and can confirm that:
  - it complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework, and
  - Overall it is consistent with other information we know from our audit of the financial statements but we have the following observations

  The Council identified in the 2013/14 AGS that the risk management strategy needed to be reviewed and updated, this did not occur and was rolled forward as an action in the 2014/15 statement. The Council should ensure the strategy is reviewed this year and that it aligns with the Council's latest practices and policies.

Request for written representations

- We have requested a management representation letter to gain management's confirmation on a number of matters: these are standard representations with the exception of the impairments of capital expenditure which has improved the performance of assets but not enhanced the value of the asset.

  In cases where the performance of an asset has been improved by work undertaken it is appropriate to capitalise such expenditure and if it is deemed that the value has not been enhanced it will then be correct to impair the expenditure. As this can be an area of judgement we are seeking specific representation from management that only expenditure improving the performance of an asset has been capitalised.

Whole of Government Accounts

- As well as our work on the financial statements, we also review and report to the National Audit Office on the Council's Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.
- We are currently concluding our work in this area and will report any matters arising to the Audit Committee.

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 Hampshire County 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 Authority 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'
- We identified one significant risks in relation to this criteria:
  - The Council continues to face financial pressures in the medium term. In March 2015, the Cabinet set out that as part of the Transformation to 2017, savings of £98 million will be required. The Council is currently working on plans to identify and implement the required savings.
- We are satisfied that the Council has put in arrangements for securing financial resilience. Our findings in respect of the risk identified is outlined in the following slides.

Criteria 2 – arrangements for securing economy, efficiency and effectiveness

- 'Whether the Authority is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity'
- We did not identify any significant risks in relation to this criteria, but we did identify the following other value for money considerations:
  - In our 2013/14 Audit Results Report, we reported that looking ahead there were significant challenges to delivering the medium term financial strategy. Particularly in respect of Adult Social Care and Children Services. We recognised that Council had identified the need for Adult Social Care and Children Services to fundamentally review their operating model and were taking action to do so;
  - In our 2013/14 Audit Results Report, we reported that the Council had established effective arrangements for managing the health integration agenda. Successful achievement of priorities is however dependent on the joint delivery of plans by partners and there remain significant financial risks associated with the Better Care Fund, particularly in respect of partner organisations delivering on their savings plans; and
  - Key objectives of the strategic partnership between Hampshire County Council, Hampshire Fire and Rescue Authority and the Chief Constable of Hampshire Constabulary and the Police and Crime Commissioner for Hampshire were to deliver: improved service performance; organisational resilience; efficiencies and cost reduction. The effective delivery of these objectives is a significant element of the Council's transformation agenda. It is therefore important that this is being effectively managed and delivery of outcomes monitored.
- We are satisfied that the Council has put in arrangements for securing economy, efficiency and effectiveness. Our findings in respect of the risk identified is outlined in the following slides.

Addressing audit risks – significant VFM risks

We identified the following VFM 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 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 undertaken additional audit work to enable them to reach an appropriate conclusion.

VFM risk identified within our Audit Plan	Audit approach	Assurance gained and issues arising
Significant VFM risks		
Securing financial resilience The Council continues to face financial pressures in the medium term. In March 2015, the Cabinet set out that as part of the Transformation to 2017, savings of £98 million will be required. The Council is currently working on plans to identify and implement the required savings.	Our approach focused on: ▸ Assessing the robustness of processes for identifying and implementing savings; and ▸ Reviewing the Medium Term Financial Plans to 2017/18 and the associated savings plan.	The Council has programmes in place to deliver the £102.5 million 2015 Transformation target. In the Shaping Hampshire 2014/15 Annual Performance Report the Council outlined that in 2014/15 £83.6 million of efficiency savings were delivered - against the target of £102.5 million, by April 2016. The Council is currently working on plans to deliver the £98 million To date the Council has undertaken planning to identify a top 19 programme list across key services, undertaken work to establish detailed project initiation documents, plans, resource requirements, timelines and leadership requirements. The Council also undertook a larger scale public consultation the results of which are currently being evaluated. The results of the public consultation will be factored into the initial planning that has already been undertaken before the detailed savings plan are agreed and the medium term financial strategy updated. To date the Council is taking action to establish a plan as agreed delivery will remain a challenge. Member action to monitor progress and ensure the required delivery action is undertaken will be required.

Addressing audit risks – other VFM considerations

VFM consideration identified within our Audit Plan	Audit approach	Assurance gained and issues arising
Adult Social Care and Children Services In our 2013/14 Audit Results Report, we reported that looking ahead there were significant challenges to delivering the medium term financial strategy. particularly in respect of Adult Social Care and Children Services. We recognise that the Council has identified the need for Adult Social Care and Children Services to fundamentally review their operating model and are taking action to do so.	Our approach focused on: ▸ Understanding the outcomes of the operating model review and any planned changes to service delivery.	As part of the Transformation to 2017 £98 million savings target there are a number of planned programmes for Adult Social Care and Children Services. Detailed project initiation documents have been established and reviewed for each service, which are aimed at reviewing the operating model in key areas. The results of the public consultation are now being assessed before the overall savings plan is agreed. The processes being followed in setting the target provides evidence that action is being taken address the financial challenges within these two service areas. However, both nationally and locally the demand for services is increasing and the ongoing challenge will remain, it is therefore important that once agreed planned actions are delivered.
In our 2013/14 Audit Results Report, we reported that the Council had established effective arrangements for managing the health integration agenda. Successful achievement of priorities is however dependent on the joint delivery of plans by partners and there remain significant financial risks associated with the Better Care Fund (BCF), particularly in respect of partner organisations delivering on their savings plans. In December 2014, the Cabinet received a report outlining that in respect of the BCF an efficiency target had been agreed between the Council and the five Clinical Commissioning Groups (CCG). This commits the partners to underwrite £20 million of savings in 2015/16 and 2016/17 . The report highlighted that progress on the delivery of recurring savings was slow and significant work was required to collectively deliver the target across the health and social care system.	Our approach focused on: ▸ Understanding the outcomes of the operating model review and any planned changes to service delivery.	In respect of the BCF partnership a risk share was signed for 2015/16, in this the partners agreed that in the event of savings not being delivered to the value agreed, then the shortfall will be shared between all parties, thereby mitigating the risk of the Council being solely liable for any shortfall. Recently the CCGs informed the Council that they will not sign a risk share agreement for 2016/17. Officers have also reported that it is now likely that the partners will only deliver £2.7 million of the £20 million savings target in 2015/16. The Council has planned contingencies to cover this scenario and a report of actions now required for 2016/17 is being taken to the September meeting of the Cabinet. As part of the Transformation to 2017 £98 million savings target there are a number of planned cross sector programmes which require liaison with partners across the health and social care system. However, in identifying the associated savings plans for these programmes action is being taken to ensure that responsibility for delivery lies solely with Council. Members will need to review the planned actions to assess the feasibility of delivery and ensure appropriate action is taken to mitigate potential risks to the Council.

Addressing audit risks – other VFM considerations (continued)

VFM consideration identified within our Audit Plan	Audit approach	Assurance gained and issues arising
Key objectives of the strategic partnership between Hampshire County Council, Hampshire Fire and Rescue Authority and the Chief Constable of Hampshire Constabulary and the Police and Crime Commissioner for Hampshire were to deliver: improved service performance; organisational resilience; and efficiencies and cost reduction. The effective delivery of these objectives is a key element of the Council's response to the future financial pressures. It is therefore important that this is being effectively managed and delivery of outcomes monitored.	Our approach focused on: ▸ updating our understanding of the governance arrangements, including the legal model; ▸ reviewing the reported 2015 delivery of the planned payback period against the initial one off costs and associated cost reductions; and ▸ assessing the extent to which efficiencies have been achieved and reviewing any available comparative financial information used in performance reporting.	Based on the work undertaken to date we are satisfied that appropriate governance arrangements for H3 have been established and that the legal form was properly considered. The delivery of the planned payback period and associated efficiencies have been achieved as part of the reported Transformation 2015 savings. Members will need to keep the performance of the partnership under review to ensure value for money is being achieved.

Section 6

Changes to financial reporting for the coming year

Changes to financial reporting for the coming year

Highways Network Asset (formerly Transport Infrastructure Assets):

The Invitation to Comment on the Code of Accounting Practice for 2016/17 (ITC) sets out the requirements to account for Highways Network Asset under Depreciated Replacement Cost from the existing Depreciated Historic Cost. This is to be effective from 1 April 2016.

This requirement is not only applicable to highways authorities, but to any local government bodies that have such assets.

This may be a material change of accounting policy for the Council. It could also require changes to existing asset management systems and valuation procedures.

Nationally, latest estimates are that this will add £1,100 billion to the net worth of authorities.

Potential impact

Given the size of the Highways network in Hampshire this will have a significant impact for the Council. Members will need to ensure the Council has plans in place to assess if current systems and processes are adequate to identify, administer, value and report on any requirement to account for Highways Network Asset.

Section 7

Independence and audit fees

Independence and audit fees

Independence

- We confirm there are no changes in our assessment of independence since the confirmation in our Audit Plan dated June 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 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 and that we are required by auditing and ethical standards to report to the Council.
- We consider that our independence in this context is a matter that should be reviewed by both the Council and us. It is therefore important to consider the facts of which the Council is aware and come to a view. If the Committee wish to discuss any matters concerning our independence, we will be pleased to do so at the meeting on 24 September 2015.

Reporting to Those Charged With Governance

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

Audit fees

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

	Proposed final fee 2014/2015	Scale fee 2014/2015	Variation comments
	£	£	
Audit Fee: Code work	155,358	155,358	N/A

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

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ED None

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