Brighton & Hove City Council

Audit Results Report (ISA260) for the year ended 31 March 2013

September 2013

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INVESTOR IN PEOPLE

Private and confidential
Councillor Leslie Hamilton
Chair
Audit & Standards Committee
Brighton & Hove City Council
King's House
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September 2013

Dear Les

Audit results report

We are pleased to attach our audit results report for the forthcoming meeting of the Audit & Standards Committee. This report summarises our preliminary audit conclusion in relation to Brighton & Hove City Council's (the Council's) financial position and results of operations for 2012/13.

The audit is designed to express an opinion on the 2012/13 financial statements, reach a conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources, and address current statutory and regulatory requirements. This report contains our findings related to the areas of audit emphasis, our views on the Council's accounting policies and judgments and material internal control findings.

This report is intended solely for the information and use of the Audit & Standards Committee and the Council. It is not intended to be and should not be used by anyone other than these specified parties.

A copy of this report will be sent to the Audit Commission in accordance with the requirements of its Standing Guidance.

We welcome the opportunity to discuss the contents of this report with you at the Audit & Standards Committee meeting scheduled on 24 September 2013.

Yours sincerely
For and on behalf of Ernst & Young LLP

Helen Thompson
Ernst & Young LLP
United Kingdom
Enc.

Contents

In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and audited bodies' (Statement of responsibilities). It is available from the Chief Executive of each audited body and via the Audit Commission's website.

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Audit Results Report is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Overview of the financial statement audit

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.

As auditors we are responsible for:

- forming an opinion on the financial statements;
- forming a conclusion on the arrangements that the Council has in place to secure economy, efficiency and effectiveness in its use of resources; and
- undertaking any other work specified by the Audit Commission.

Summarised below are the conclusions from all elements of our work:

Financial statements

Following the performance of the procedures outlined in our Audit Plan, we anticipate issuing an unqualified opinion on the Council's financial statements. We identified no significant risks impacting on the audit of the financial statements. Our main findings in relation to the areas of other financial statement risk included in our Audit Plan are set out below.

Other financial statement risks:

Bank reconciliations

A small number of issues were identified in your 2011/12 year end processes to reconcile your bank accounts and other cash balances reported in your financial statements. As part of our 2012/13 work to walk-through your cash and bank system we also identified an unreconciled difference between the housing benefit bank balance in your cash management system and the balance shown in the bank statement.

Findings

We are satisfied these issues have been addressed subject to a very small remaining difference on the general account reconciliation.

New long term asset and lease accounting system

You have changed the system you use to record and account for long term assets and leases during 2012/13. As part of work needed to implement the new system you have transferred and reconciled closing 2011/12 balances between the old and new systems.

Findings

We reviewed the transfer and reconciliation of closing 2011/12 balances between your old and new systems to ensure that balances have been brought forward correctly to 2012/13 in the new system. This work identified no issues that we wish to bring to your attention.

Payroll

In previous years both external and internal audit have reported significant weaknesses in the internal control environment within your payroll system. Although controls have been capable of giving material assurance they have not been operated effectively and therefore have not been considered to reliable. Weaknesses in the control environment were further exacerbated by the inherent complexity of your payroll.

Findings

We substantively tested payroll transactions to gain assurance for our opinion on the 2012/13 financial statements. Although we have not identified material errors, our work confirms that your payroll remains highly complex, particularly in terms of the number of different allowances payable. This increases the risk of both error and fraud occurring.

Journals processed on the general ledger

External audit has identified in previous years that manual adjustment journals processed on the general ledger are not always subject to formal checking and authorisation. This creates a risk that income and expenditure is misclassified on the general ledger and misreported in your financial statements. In response to this issue in 2011/12 you introduced a scheme of on-screen authorisation for journals that are considered to be high risk or more complex. However, internal audit identified and reported weaknesses in the new scheme caused by the failure to follow guidance consistently. As a result, you subsequently issued updated guidance in December 2012.

Findings

We tested the authorisation control you have established over high risk or more complex journals and found it to be operating effectively. We also used our computer-based analytics tool to support our substantive testing of journals. This allowed us to consider the entire journal population and facilitated a more risk-based approach which also considers indicators of process inefficiency and internal control breakdown. We considered the output from our interrogation of your journals, followed up outliers and unusual trends and tested a sample of journals using a risk-based approach. Our work in this area identified no errors or other issues.

Pensions disclosures in the financial statements

You participate in the local government pension scheme administered locally by East Sussex County Council. Each year you commission Hymans Robertson LLP, an independent firm of actuaries, to assess the value of your pension fund assets and liabilities. This work informs disclosures in your financial statements. Some weaknesses in your arrangements to process entries in the financial statements have been raised in previous reports to those charged with governance.

Findings

Our work found that you have made some improvements in your arrangements in this area and have established processes to better understand the basis of the estimate of employer contributions used by the actuary to inform their work, and assess the reasonableness of entries processed in the financial statements that are based on the actuarial valuation. You recognise there remains scope to continue to improve these processes. In light of this you plan to reduce the level of tolerance you apply in your checking process and undertake a more sophisticated analysis of changes in employee data made in the final quarter of the year to better assess the accuracy of the estimate of full year employer contributions provided to the actuary.

Risk of misstatement due to fraud and error

Management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Findings

We identified no material misstatements or evidence of material fraud. We do, however, continue to note that the high level of complexity of your payroll increases the risk of undetected fraud and error occurring in this area.

Economy, efficiency and effectiveness

Following the performance of the procedures outlined in our Audit Plan, we anticipate issuing an unqualified value for money conclusion.

Whole of Government accounts

We have completed the work required to issue our report to the National Audit Office on the accuracy of the consolidation pack the Council is required to prepare for the Whole of Government Accounts. We have no issues to report.

Control themes and observations

Our audit has not identified any significant control issues that we are required to bring to your attention

Summary of audit differences

Our audit identified a relatively small number of misstatements in the accounts presented for audit. These are detailed in Section 3 of this report.

Scope update

Our 2012/13 audit work has been undertaken in accordance with the Audit Plan that we presented to the Audit & Standards Committee on 16 April 2013 and is conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

Our work comprises a number of elements. In our Audit Plan, we provided you with an overview of our audit scope and approach for the audit of the financial statements, our conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources, and the work that we are required to perform in respect of the Whole of Government Accounts return.

We carried out our work in accordance with our Audit Plan.

Significant findings from the financial statement audit

In this section of our report, we outlined the main findings from our audit of your financial statements, including our conclusions in relation to the areas of risk outlined in our Audit Plan. We identified no significant risks impacting on the audit of the financial statements. Our main findings in relation to the areas of other financial statement risks included in our Audit Plan are set out below.

Bank reconciliations

A small number of issues were identified in your 2011/12 year end processes to reconcile your bank accounts and other cash balances reported in your financial statements. The following differences were reported as part of the 2011/12 year end report to those charged with governance:

- A difference of £60,000 between the bank balance on the general ledger and your reconciliation schedule relating to schools cash balances. This difference was originally caused by the merger of two schools in 2010/11.
- An unmatched balance on the reconciliation of your payments accounts of approximately £80,000 which originates from the bank reconciliation module of your cash management system.

You have been working with your cash management system supplier during the year to address differences in reconciliations and good progress has been made. However, there remained small historic differences on both your general and payment accounts reconciliations that you were continuing to investigate before year-end.

At the interim stage we were not able to substantiate that the £60,000 difference relating to schools cash balances had been fully cleared due to slippage in the quarterly programme of school balance reconciliations in the year.

Finally, as part of our work to walk-through your cash and bank system we identified an unreconciled difference of approximately £21,900 between the housing benefit bank balance in your cash management system and the balance shown in the bank statement.

Our response and findings

We considered each of these issues as part of our testing of your year-end bank reconciliations.

- The £60,000 difference between the bank balance on the general ledger and your reconciliation schedule relating to schools cash balances was resolved by the time of the year end reconciliation. Delays in the performance of quarterly schools reconciliations noted as part of our interim work had also been addressed by the end of the year.
- Work has been undertaken with your cash management system supplier during the year to address the unmatched balance on the reconciliation of your payments account. Good progress has been made although a small difference of approximately £810 remains on your year-end general account reconciliation.
- The unreconciled difference of approximately £21,900 relating to the housing benefit bank account was resolved by the time of the year-end reconciliation.

New long term asset and lease accounting system

You have changed the system you use to record and account for long term assets and leases during 2012/13. Your new Logotech system should enable you to comply more easily with the accounting and disclosure requirements required by international financial reporting standards in this area.

As part of work needed to implement the new system you have transferred and reconciled closing 2011/12 balances between the old and new systems.

Our response and findings

As part of our work we reviewed and tested the transfer and reconciliation of closing 2011/12 balances between your old and new systems to ensure that balances have been brought forward correctly to 2012/13 in the new system. This work identified no issues that we wish to bring to your attention.

Payroll

In previous years both external and internal audit have reported significant weaknesses in the internal control environment within your payroll system. Although controls have been capable of giving material assurance they have not been operated effectively and therefore have not been considered to reliable. Weaknesses in the control environment were further exacerbated by the inherent complexity of your payroll.

You have worked to simplify your payroll and improve the operation of controls. This work has been actively considered by senior officers, the Audit & Standards Committee and internal audit.

This work has been ongoing during the 2012/13 year and improvements in the control environment have not operated consistently throughout the whole period. We are therefore not able to rely on the operation of controls to gain assurance for our opinion on your 2012/13 financial statements.

Our response and findings

We substantively tested payroll transactions to gain assurance for our opinion on the 2012/13 financial statements. We planned to use our computer-based analytics tool to extract and interrogate data from the payroll system. This would allow us to consider the entire population of data and facilitate a more risk-based approach which also considers indicators of process inefficiency and internal control breakdown.

We were not able to use our analytics tool to its full potential because of difficulties in completely and accurately mapping the data extracted from your payroll system to the standard parameters used by the tool. This was caused by the high level of complexity of your payroll, and in particular the high number of different allowances paid. We will continue to work with your payroll team during the course of 2013/14 to resolve some of the issues faced in 2012/13 and maximise the potential benefits of the analytics tool.

Our detailed substantive testing of payroll transactions did not identify any material errors. There were, however, difficulties in providing evidence to provide complete support for all elements of payments and deductions. This was again caused, in part, by the high level of complexity of the payroll and the relatively large number of categories of allowances and deductions. We have concluded that the high level of complexity of your payroll increases the risk of both error and fraud occurring, although this risk is unlikely to be material. The work you are currently undertaking on pay modernisation should result in simplification of the Council’s payroll and reduce this risk of fraud and error.

Journals processed on the general ledger

Manual adjustment journals processed on the general ledger are not always subject to formal checking and authorisation. This creates a risk that income and expenditure is misclassified on the general ledger and misreported in your financial statements.

This weakness was raised in the 2009/10, 2010/11 and 2011/12 reports to those charged with governance.

In response to this issue in 2011/12 you introduced a scheme of on-screen authorisation for journals that are considered to be high risk or more complex. However, internal audit identified and reported weaknesses in the new scheme caused by the failure to follow guidance consistently which resulted in gaps in documentation retained to support journal entries made. You subsequently issued updated guidance in December 2012.

Our response and findings

We tested the authorisation control you have established over high risk or more complex journals and found it to be operating effectively.

We substantively tested journals as part of our work on your financial statements and used our computer-based analytics tool to support this work. This allowed us to consider the entire journal population and facilitated a more risk-based approach which also considers indicators of process inefficiency and internal control breakdown. We considered the output from our interrogation of your journals, followed up outliers and unusual trends and tested a sample of journals in details using a risk-based approach. Our work in this area identified no errors or other issues.

Pensions disclosures in the financial statements

You participate in the local government pension scheme administered locally by East Sussex County Council. Each year you commission Hymans Robertson LLP, an independent firm of actuaries, to assess the value of your pension fund assets and liabilities. This work informs disclosures in your financial statements.

Some weaknesses in your arrangements to process entries in the financial statements have been raised in previous year reports to those charged with governance. Specifically:

- There is scope to improve communication between your payroll and central accounting teams on the basis of the estimate of employer contributions made in the period that is provided to the actuary and used to inform its estimate of scheme assets and liabilities.

- There is scope to better challenge the data provided in the actuarial valuation for reasonableness prior to entries being processed in the financial statements.

Our response and findings

We reviewed pension scheme disclosure in your financial statements. This included consideration of the accuracy of estimates informing those disclosures and your internal processes to review the actuarial valuation for reasonableness. Our work found that you have made some improvements in your arrangements in this area. Specifically you review some of the disclosures in the actuarial valuation against expectations and follow-up if a defined level of tolerance from your expectation is exceeded. However, you recognise that there remains scope to continue to improve these checking processes. In light of this you plan to reduce the level of tolerance you apply and undertake a more sophisticated analysis of changes in employee data made in the final quarter of the year to better assess the accuracy of the estimate of full year employer contributions provided to the actuary. See recommendation 1.

Recommendation 1

Implement your planned improvements to the checks undertaken on the reasonableness of estimated data used to inform the actuarial valuation.

Risk of misstatement due to fraud and error

Management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Our response and findings

Based on the requirements of auditing standards our approach focused on:

- Identifying fraud risks during the planning stages.
- Inquiry of management and internal audit about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.
- Performing mandatory procedures regardless of specifically identified fraud risks.

We also considered the results of the National Fraud Initiative as relevant to this area.

We identified no material misstatements or evidence of material fraud. We do, however, continue to note that the high level of complexity of your payroll increases the risk of undetected fraud and error occurring in this area.

Summary of Audit Differences

In the normal course of any audit, we identify differences between amounts we believe should be recorded in the financial statements and amounts actually recorded. These differences are classified as either 'known' or 'judgemental'. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

Corrected Misstatements

Our audit identified one material misstatement. This related to the valuation of Brighton Pavilion. The misstatement was judgemental in nature and had no impact on the Council's reported financial performance.

Only a relatively small number of presentation and disclosure amendments were required to the financial statements. We have concluded that you continue to produce good quality draft financial statements. The financial statements submitted for audit were complete, supported by the working papers we requested, internally consistent and generally compliant with extant accounting and disclosure requirements. This is a result of effective closedown processes and arrangements to produce and quality review the draft financial statements prior to submission for audit.

We highlight in particular the following misstatements identified during the course of our audit that have been corrected by management:

- Comprehensive Income and Expenditure Statement (CIES) – Our detailed testing identified that income and expenditure shown in the Cultural Services section of the CIES was over-stated by approximately £1.2 million. We were not able to conclude that this error was isolated. As a result of this you undertook work which identified a further £5.5 million of similar errors within net cost of services. The errors were caused by internal re-charge and budget adjustment journals not being eliminated from the financial statements. The Council should review its processes to ensure that all internal re-charge and budget adjustment journals are identified and eliminated from income and expenditure disclosed as part of the financial statements. See recommendation 2.

- Note 17 (heritage assets) – The closing 2012/13 carrying value of the Royal Pavilion was under-stated by approximately £22 million. You had initially reduced the insurance value by 15 per cent to arrive at the carrying value in the financial statements to reflect the proportion of the insurance valuation relating to fixtures, fittings and other contents. We challenged the basis for this accounting estimate. On further consideration you decided that the value of fixtures and fittings was likely to be nominal and that it was not appropriate to reduce the insurance valuation by 15 per cent to arrive at the carrying value in the financial statements. You have also disclosed a prior period adjustment in relation to this issue.

- Note 37 (debtors) - Primary care trust and strategic health authority debtors had been disclosed as relating to central government. The accounts have been amended to reflect their correct classification as debtors with NHS bodies. The total value of the reclassification was approximately £2 million.

- Note 39 (financial instruments) – There were a number of adjustments to debtors (financial assets) and creditors (financial liabilities) disclosed in the financial statements. The gross value of the adjustments to the financial instruments disclosure in 2012/13 was approximately £14.7 million. Adjustments were also made to prior year comparatives to consistently apply the changed approach to the classification of financial assets and liabilities. All the adjustments made in this area are disclosure only and relate only to the financial instrument note. As part of our work in this area we note that the Council still excludes all Private Finance Initiative (PFI) and finance lease assets and liabilities from its financial instrument disclosure. Although these assets and liabilities are disclosed elsewhere is the statements and a cross reference is added to relevant notes the Council should continue to consider its approach to ensure it complies with the requirements of the Code. See recommendation 3.

- The Code of Practice on Local Authority Accounting (the Code) requires the disclosure of an analysis of the age of financial assets that are past due as at the reporting date but not impaired by class of financial asset. No such disclosure was made in the draft financial statements. You have now updated note 39 (financial instruments) to include this disclosure.

Recommendation 2

The Council should review its processes to ensure that all internal re-charge and budget adjustment journals are identified and eliminated from income and expenditure disclosed as part of the financial statements.

Recommendation 3

Continue to consider the current disclosure of PFI and finance lease financial instruments in the financial statements to ensure it is compliant with the requirements of the Code.

The corrected errors had no impact on the Council's reported out-turn position.

Uncorrected misstatements

Our audit identified the following uncorrected misstatements that we need to bring to your attention. The Audit & Standards Committee should consider whether to adjust the errors in the financial statements we have identified that management has not amended, or set out the reasons for not amending the errors.

- Note 22 (leases and lease type arrangements) – our sample testing of leases identified an error in the analysis of future minimum lease payments due under operating leases where the Council is lessor. We extrapolated the error to determine the overall impact on the financial statements. Based on this the total value of the uncorrected errors in the disclosure at Note 22 is £5,640,000.

- Note 38 (creditors) – our sample testing of creditors identified an over-accrual of capital creditors. The total value of the accrual made was approximately £805,000 and the value of the over-accrual was approximately £532,000. We have not been able to conclude this error is isolated and have performed an extrapolation to estimate the impact on the total creditors value disclosed in the financial statements. Based on this extrapolation we have concluded that the total value of creditors in the financial statements is over stated by £2,045,000. We identified two other low value errors in your accrual processes as a result of our work. Although arrangements to ensure accruals are properly raised remain adequate overall you should revisit your arrangements in this area to ensure they remain fit for purpose and are adequately communicated. See recommendation 4.

Recommendation 4

Revisit your accruals processes to ensure they remain fit for purposes and are adequately communicated.

Economy, efficiency and effectiveness

The Code of Audit Practice 2010 sets out our responsibility to satisfy ourselves that the 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 areas of focus specified by the Audit Commission:

- 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; and
- 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 considering your arrangements we have also considered the key areas of focus set out in the Audit Plan:

- 2013/14 budget setting, and medium term financial planning arrangements, including assumptions made in response to the 2013/14 and provisional 2014/15 settlements.
- The Council's ongoing response to the recent significant legislation, including the 2011 Localism Act, (in respect of local taxation and changes to governance, scrutiny and standards), the Welfare Reform Act 2012 and the Local Government Finance Act 2012.
- Review the Audit Commission's VFM profile data in respect of the Council together with review of the Council's own VFM improvement programme.

Financial Resilience

We are required to assess the Council's arrangements for securing financial resilience. This includes an assessment of 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. The financial resilience criterion has three aspects:

- financial governance;
- financial planning; and
- financial control.

Financial governance

Senior management has been subject to significant changes during 2012/13 with the departure of the Chief Executive and three of the Council's strategic directors. The Council's current chief executive came into post in December 2012 and a new Council management structure was established with effect from April 2013. The current Executive Director for Finances and Resources has been the section 151 officer throughout this period of change and temporarily acted as interim Chief Executive. This has provided continuity of understanding of the significant and rapidly changing financial management challenges and risks facing the Council and stability in its arrangements to ensure that its sound financial position is maintained.

At a high level the Council has continued to use its ‘Targeted Budget Management' (TBM) approach to monitor financial performance. TBM is a key component of the Council’s overall performance monitoring and control framework. Monthly reports are produced which set out the forecast outturn position on the Council’s revenue and capital budgets for the financial year. The process focuses in particular on 'corporate critical budgets', which are those budgets thought to be the most risky and likely to overspend, and significant variances and trends that are identifiable.

This Council’s Policy and Resources (P&R) Committee has overall responsibility for the financial and other resources of the Council, for developing the Council’s strategy and policy based on national government and local priorities, and for the development of partnership working. It also has responsibility for many of the services delivered to residents and customers. The P&R committee receives financial updates on budget monitoring through TBM, budget development and other ad hoc reports on developments with major financial implications for the Council in the ‘financial matters’ section of meetings. This allows challenge of officer reporting of financial performance, budget development and other financial matters.

The Council has also updated its broader governance arrangements to address the significant changes arising from the Localism Act 2011, including the general power of competence and the abolition of the Standards Board regime.

Financial planning

The Council has set out its key priorities for the period 2011-2015 in its corporate plan. The corporate plan is supported by a medium term financial strategy (MTFS) which is updated annually as part of the budget setting process.

The Council has conducted its annual refresh of its MTFS which now extends to 2018/19. The refresh considers the impact of the 2013/14 budget settlement and the very significant financial challenges facing the Council over the next six years. It forecasts that the Council will need to identify new savings of about £120 million over the six years 2013/14 to 2018/19. This represents a reduction of about 30 per cent in its gross general fund budget. The MFTS recognises that the Council has relatively high unit costs in areas such as social care for adults and children that will need to be addressed. This is supported by our analysis of the Audit Commission’s value for money profiles. The updated MTFS also recognises that a number of other strategies need to be followed to maintain a stable financial position:

- growth of the council tax base and business rates tax base;
- maximising fees, charges and rents;
- supporting adult social care clients to stay in their own homes;
- improvement of procurement and commissioning;
- prioritising prevention and early intervention in children’s services;
- seeking to leverage external investment;
- working in partnership with the community and voluntary sector; and
- moving some (typically discretionary) services onto a more independent and commercial basis.

The update of the MTFS demonstrates a clear consideration of the financial impacts of recent legislative changes including;

- localisation of council tax support;
- the new business rate retention scheme. In particular, significant provision is being made in future budgets for increased costs to the Council arising from it having to fund the financial impact of successful appeals against rating valuations by local businesses;
- changes in the level of benefit payments and funding and associated impacts this may have in other areas of service provision such as homelessness; and
- increased freedom in the use of available grant funding, for example via the local services support grant.

In setting its 2013/14 budget the Council has recognised that a number of 2014/15 proposals have needed to be fast-tracked to maintain a sustainable financial position. The Council has also considered external research on local inflationary and demand related cost pressures mainly in relation to social care, energy and environmental costs in its budget setting. It recognises that, unless these cost pressures can be effectively managed, the Council is unlikely to be able to sustain support for other services in their current form over the medium term.

Financial control

The TBM framework focuses on identifying and managing financial risks on a regular basis throughout the year. This is applied at all levels of the organisation from budget managers through to the Policy & Resources Committee. Monthly TBM reports are also considered by senior management. Services monitor their TBM position on a monthly or quarterly basis depending on the size, complexity or risks apparent within a budget area. TBM therefore operates on a risk-based approach, paying particular attention to mitigation of growing cost pressures, demands or overspending together with more regular monitoring of high risk ‘corporate critical’ areas.

The Council continues to have a good track record of maintaining its spending within budget. The provisional 2012/13 out turn position reported for the General Fund is an under-spend of £4.610 million compared to £4.513 million assumed at budget setting time. The provisional out turn for the Housing Revenue Account is an under-spend of £1.963 million and the provisional out turn for the Dedicated Schools Grant is an under-spend of £1.089 million. The overall level of under-spending delivered in 2012/13 slightly out performs the target level of under-spending for the year set out in the Council’s medium term financial plans.

Economy, efficiency and effectiveness

We are also required to assess the Council’s arrangements for securing economy, efficiency and effectiveness. This criterion has two aspects:

- prioritising resources; and
- improving efficiency and productivity.

Prioritising resources

2013/14 budget setting and the annual refresh of the MTFS show an awareness of the scale of the medium term financial challenges faced the Council and a growing acceptance that it will need to think more radically about its current methods and level of service provision if it is to deliver the value for money improvement needed to maintain a stable financial position.

The Council makes use of cost and performance information to assess the impact of spending decisions and monitor the delivery of its savings plans, and to help ensure spending cuts are not having detrimental impact on service quality and performance in priority areas. There is an annual city performance plan (CPP). That is considered by Full Council, the P&R Committee and the Overview and Scrutiny Committee as part of the Council's overall performance and risk management framework. The CPP has moved away from being performance indicator driven towards reporting progress on city outcomes. Reporting outlines current activity, future activity, and barriers for each outcome and associated priority area. There are key indicators in each outcome area in order to offer additional performance information in assessing progress. Out turn against the CPP is reported annually as part of the Council's annual performance update, with a full update reported at six months. The annual performance update consolidates information from the three major performance management reports for the city and Council:

- the CPP;
- the corporate plan; and
- the organisational health report, which contains key council service performance information.

No significant deterioration in performance was reported in the 2012/13 annual performance update. The P&R committee receives budget monitoring reports under the TBM process and performance reports under the CPP process and therefore is able to link financial performance and priorities to service performance and outcomes against priorities.

The 2012/13 budget includes a number of examples of partnership working across the city, particularly with health and on community safety activity. There are well established partnerships under section 75 of the NHS Act 2006 for the commissioning and integrated provision of services to children, adults and older people, although these need to be fully reassessed in the light of structural change in the National Health Service. There is also recognition that partnership working will need to continue and be strengthened to ensure that all partners in the city, including the broader community and voluntary sector, understand how collective resources can be best used to maximise benefit overall.

Improving efficiency and productivity

The Council has a well established value for money (VFM) programme and a good track record of delivering its planned savings that has continued into 2012/13. Total 2012/13 VFM savings of £10.080 million have been achieved against an original target of £6.933 million, representing an over-achievement of 45 per cent. This was mainly due to an overachievement in children's services. An underachievement of £0.377 million was experienced in relation to corporate VFM savings.

The Audit Commission produces value for money and financial ratio profiles for local authorities on an annual basis. This provides an indication of the relative performance of an individual body against a comparator group of statistical nearest neighbours which have similarities in population, expenditure, and geographical area. We have used the latest available VFM profile data, largely relating to financial year 2011/12, to review the cost and efficiency of Council services relative to others.

Review of the VFM profile data shows that the Council remains high spending compared to its statistical nearest neighbours. This is true for both its overall per capita spending, and per capita spending in each of its main service areas. Spending is decreasing in the majority of areas but not at a faster rate than at statistically similar authorities. Spend per head is particularly high in children's services and housing services, where it is in the top five per cent relative to comparable authorities. The need to reduce relatively high unit costs in high spending, demand led service areas is explicitly recognised by the Council in its 2012/13 refresh of the MTFS. In terms of financial resilience, both the absolute value of the council tax financing requirements and the value of income from fees and charges remain in the top ten per cent, which is consistent with the high level of relative spend on services. The Council's comparative financial standing remains sound, with a relatively high level of non-schools reserves as a percentage of spend.

Control themes and observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal of internal control we are required to communicate to you significant deficiencies in internal control.

The matters reported below are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported to you.

We undertook work during the year to gain an understanding of the Council's material contracts. This showed that the Council did not have a complete or up to date master register of all its contracts. Some records were maintained by both the Council's legal and procurement teams but neither was fully complete. A complete record of all contracts over £75,000 requiring the corporate seal at the end of 2012/13 has now been established by legal services. This should be used as a starting point for population of the Council's new contract monitoring system. See recommendation 5.

Recommendation 5

Use the record of all contracts over £75,000 as a starting point for population of the Council's new contract monitoring system.

Information technology general controls

As part of our work on the financial statements we performed a review of the design and operating effectiveness of information technology general controls (ITGCs) over the significant financial applications supporting the accounts. Our procedures included documenting the significant computer applications, documenting controls related to changes to production programs and logical access to data and programs. The scope of our review focused primarily on the production environment for the Civica Financials and Civica Purchasing systems.

We have concluded that we are able to rely on ITGCs within Civica Financials and Civica Purchasing to support our audit of the financial statements. We have, however, made a number of observations and raised detailed recommendations as a result of our work in this area. A separate memo has been produced to report the outcome of this work. This includes details of recommendations agreed with officers.

Progress update

Financial statement audit

Our audit work in respect of our opinion on the Council's financial statements is substantially complete. The following items relating to the completion of our audit procedures were outstanding at the date of this report.

Item	Actions to resolve	Responsibility
Letter of representation	To be approved at the 24 September Audit & Standards Committee.	Management and Audit & Standards Committee
WGA	Work is complete but amendments need to be made to the consolidation return.	EY and Central Accounting
External confirmation of borrowing	One confirmation remains outstanding	EY and Strategic Finance

On the basis of our work performed to date, we anticipate issuing an unqualified auditor's report in respect of the Council's financial statements. However, until we have completed our outstanding procedures, it is possible that further matters requiring amendment may arise.

Economy, efficiency and effectiveness

Our work in respect of our conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources is complete.

We expect to present an unqualified value for money conclusion in regard to the Council's arrangements to ensure economy, efficiency and effectiveness in its use of resources.

Objections

We have not received any objections to the 2012/13 accounts from members of the public as at the date of this report.

Fees update

A breakdown of our agreed fee is shown below.

	Proposed final fee 2012/13 £	Planned fee 2012/13 £	Scale fee 2012/13 £'000
Total Audit Fee – Code work	210,330	210,330	210,330
Certification of claims and returns	See Note 1	23,700	23,700

Our actual fee is in line with the agreed fee.

Fees for the auditor's consideration of correspondence from the public and formal objections are charged in addition to the scale fee.

Note 1: Our fee for certification of grants and claims is yet to be finalised for 2012/13 and will be reported to those charged with governance in January 2014 within the Audit Certification Report for 2012/13.

Summary of audit differences

In the normal course of any audit, we identify differences between amounts we believe should be recorded in the financial statements and amounts actually recorded. These differences are classified as either ‘known’ or ‘judgemental’. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

We have included all amounts greater than £12 million in our summary of misstatements below. We highlight the following misstatements identified during the course of our audit that have been corrected by management:

- Note 17 (heritage assets) – The value of the Royal Pavilion was under-stated by approximately £22 million. You had initially reduced the insurance value by 15 per cent to arrive at the carrying value in the financial statements to reflect the proportion of the insurance valuation relating to fixtures, fittings and other contents. We challenged the basis for this accounting estimate. On further consideration you decided that the value of fixtures and fittings was likely to be nominal and that it was not appropriate to reduce the insurance valuation by 15 per cent to arrive at the carrying value in the financial statements. You have also disclosed a prior period adjustment in relation to this issue.

- Note 39 (financial instruments) – There were a number of adjustments to debtors (financial assets) and creditors (financial liabilities) disclosed in the financial statements. The gross value of the adjustments to the financial instruments disclosure in 2012/13 was approximately £14.7 million. Adjustments were also made to prior year comparatives to consistently apply the changed approach to the classification of financial assets and liabilities. All the adjustments made in this area are disclosure only and relate only to the financial instrument note.

There were no misstatements greater than £12 million that management has declined to correct. There are two uncorrected misstatements that we need to draw to your attention. The Audit & Standards Committee should consider whether to adjust the errors in the financial statements we have identified that management has not amended, or set out the reasons for not amending the errors.

- Note 22 (leases and lease type arrangements) – our sample testing of leases identified an error in the analysis of future minimum lease payments due under operating leases where the Council is lessor. We extrapolated the error to determine the overall impact on the financial statements. Based on this the total value of the uncorrected errors in the disclosure at Note 22 is £5,640,000.

- Note 38 (creditors) – our sample testing of creditors identified an over-accrual of capital creditors. The total value of the accrual made was approximately £805,000 and the value of the over-accrual was approximately £532,000. We have not been able to conclude this error is isolated and have performed an extrapolation to estimate the impact on the total creditors value disclosed in the financial statements. Based on this extrapolation was have concluded that the total value of creditors in the financial statements is over stated by £2,045,000.

Independence confirmation: update

We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan. We complied with the Ethical Standards for Auditors and the requirements of the Standing Guidance and 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 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 & Standards Committee on 24 September 2013.

Appendix A Communications with the Audit & Standards Committee

There are certain communications that we must provide to the Audit & Standards Committee. These are detailed here:

Required communication	Reference
Terms of engagement	The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies
Planning and audit approach Communication of the planned scope and timing of the audit including any limitations.	Audit Plan
Significant findings from the audit ► Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ► Significant difficulties, if any, encountered during the audit ► Significant matters, if any, arising from the audit that were discussed with management ► Written representations that we are seeking ► Expected modifications to the audit report ► Other matters if any, significant to the oversight of the financial reporting process ► Findings and issues regarding the opening balance on initial audits	Audit results report
Misstatements ► Uncorrected misstatements and their effect on our audit opinion ► The effect of uncorrected misstatements related to prior periods ► A request that any uncorrected misstatement be corrected ► In writing, corrected misstatements that are significant	Audit results report
Fraud ► Enquiries of the audit committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ► Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ► A discussion of any other matters related to fraud	Understanding how the those charged with governance gain assurance from management obtained via letter from Chair of the Audit & Standards Committee . This was considered at the 16 April meeting of the Audit & Standards Committee

<table>
<tr><th>Required communication</th><th>Reference</th></tr>
<tr><td>Related parties
Significant matters arising during the audit in connection with the entity’s related parties including, when applicable:
► Non-disclosure by management
► Inappropriate authorisation and approval of transactions
► Disagreement over disclosures
► Non-compliance with laws and regulations
► Difficulty in identifying the party that ultimately controls the entity</td><td>Audit results report – no significant matters arising</td></tr>
<tr><td>External confirmations
► Management’s refusal for us to request confirmations
► Inability to obtain relevant and reliable audit evidence from other procedures</td><td>Not applicable</td></tr>
<tr><td>Consideration of laws and regulations
► Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off
► Enquiry of the audit committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the audit committee may be aware of</td><td>Understanding how those charged with governance gain assurance from management obtained via letter from Chair of the Audit & Standards Committee. This was considered at the 16 April meeting of the Audit & Standards Committee</td></tr>
<tr><td>Independence
Communication of all significant facts and matters that bear on Ernst & Young’s objectivity and independence
Communication of key elements of the audit engagement partner’s consideration of independence and objectivity such as:
► The principal threats
► Safeguards adopted and their effectiveness
► An overall assessment of threats and safeguards
► Information about the general policies and process within the firm to maintain objectivity and independence</td><td>Audit Plan and update in section 8 of this report</td></tr>
<tr><td>Going concern
Events or conditions identified that may cast significant doubt on the entity’s ability to continue as a going concern, including:
► Whether the events or conditions constitute a material uncertainty
► Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements
► The adequacy of related disclosures in the financial statements</td><td>Audit results report – no such concerns have been identified</td></tr>
<tr><td>Significant deficiencies in internal controls identified during the audit</td><td>Audit results report – no significant deficiencies identified</td></tr>
</table>

Required communication	Reference
Group audits ► An overview of the type of work to be performed on the financial information of the components ► An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ► Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ► Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ► Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Not applicable
Opening Balances ► Findings and issues regarding the opening balance of initial audits	Audit results report – no significant issues identified
Fee reporting ► Final, planned and scale fee broken down into the headings of Code audit work; certification of claims and returns; and any non-audit work (or a statement to confirm that no non-audit work has been undertaken for the body).	Audit Plan and Audit results report
Summary of certification work undertaken ► Annual report to those charged with governance summarising the certification work undertaken	Annual Certification Report – to be issued in January 2014

Appendix B Request for a letter of representation

To: Catherine Vaughan, Executive Director Finances & Resources

Dear Catherine

Brighton & Hove City Council– 2012/13 financial year
Request for a letter of representation

International Standards on Auditing set out guidance on the use by auditors of management representations (ISA (UK&I) 580) and on possible non-compliance with laws and regulations (ISA (UK&I) 250). I have interpreted this guidance as it affects local government bodies and I expect the following points to apply:

- ► auditors may wish to obtain written representation where they are relying on management's representations in respect of judgemental matters (for example the level of likely incidence of a claim), which may not be readily corroborated by other evidence;
- ► auditors are likely to request written representations on the completeness of information provided;
- ► auditors may wish to obtain written representation on issues other than those directly related to the Statement of Accounts;
- ► the letter is dated on the date on which the auditor signs the opinion and certificate;
- ► the letter is signed by the person or persons with specific responsibility for the financial statements; and
- ► the letter is formally acknowledged as having been discussed and approved by the Audit & Standards Committee, as those charged with governance of the Council.

I would expect the letter of representation to include the following matters.

A. Financial Statements and Financial Records

1. That you have fulfilled your responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with the CIPFA Code of Practice on Local Authority Accounting (CIPFA Code).

2. That you acknowledge your responsibility for the fair presentation of the financial statements. You believe the financial statements referred to above give a true and fair view of the financial position, financial performance and cash flows of the Council in accordance with the CIPFA Code and are free of material misstatements, including omissions. You have approved the financial statements.

3. You confirm that as Responsible Officer you have:

   - ► reviewed the accounts;

   - ► reviewed all relevant written assurances relating to the accounts; and

   - ► made other enquiries as appropriate.

4. That the significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.

5. That you believe that the Council has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA Code that are free from material misstatement, whether due to fraud or error.

6. You believe that the effects of any unadjusted audit differences, summarised in the accompanying schedule, during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. Reasons for not correcting each of the uncorrected misstatements are as follows:

   <u>Note 22 leases and lease type arrangements</u>

   <u>Note 38 (creditors</u>

B. Fraud

1. You acknowledge that you are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.

2. You have disclosed to us the results of your assessment of the risk that the financial statements may be materially misstated as a result of fraud.

3. You have no knowledge of any fraud or suspected fraud involving management or other employees who have a significant role in the Council's internal controls over financial reporting. In addition, you have no knowledge of any fraud or suspected fraud involving other employees in which the fraud could have a material effect on the financial statements. You have no knowledge of any allegations of financial improprieties, including fraud or suspected fraud, (regardless of the source or form and including without limitation, any allegations by "whistleblowers") which could result in a misstatement of the financial statements or otherwise affect the financial reporting of the Council.

C. Compliance with Laws and Regulations

1. You have disclosed to us all known actual or suspected non compliance with laws and regulations whose effects should be considered when preparing the financial statements.

D. Information Provided and Completeness of Information and Transactions

1. You have provided us with:

   ► access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters as agreed in terms of the audit engagement;

   ► additional information that we have requested from us for the purpose of the audit; and

   ► unrestricted access to persons within the entity from whom we determined it necessary to obtain audit evidence.

2. That all material transactions have been recorded in the accounting records and are reflected in the financial statements.

3. That you have made available to us all minutes of the meetings of the Council and its relevant committees (or summaries of actions of recent meetings for which minutes

have not yet been prepared) held through the year to the most recent meeting on the following date: 24 September 2013.

4. That you confirm the completeness of information provided regarding the identification of related parties. You have disclosed to us the identity of the Council related parties and all related party relationships and transactions of which you are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the financial statements.

5. That you have disclosed to us, and the Council has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

E. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to us and are appropriately reflected in the financial statements.

2. That you have informed us of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.

3. That you have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent, and have disclosed in the financial statements all guarantees that you have given to third parties.

F. Subsequent Events

1. That other than described in the financial statements, there have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

G. Accounting Estimates

1. That you believe that the significant assumptions you used in making accounting estimates, including those measured at fair value, are reasonable.

2. In respect of accounting estimates recognised or disclosed in the financial statements:

    - ► That you believe the measurement processes, including related assumptions and models, you used in determining accounting estimates is appropriate and the application of these processes is consistent.

    - ► That the disclosures relating to accounting estimates are complete and appropriate in accordance with the applicable financial reporting framework.

    - ► That the assumptions you used in making accounting estimates appropriately reflects your intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.

    - ► That no subsequent event requires an adjustment to the accounting estimates and disclosures included in the financial statements.

H. Retirement benefits

1. On the basis of the process established by you and having made appropriate enquiries, you are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with your knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

I. Segmental reporting

1. That you have reviewed the operating segments reported internally to the management team and Council and that you are satisfied that it is appropriate to aggregate these as, in accordance with IFRS 8:Operating Segments, they are similar in each of the following respects:

   - The nature of the products and services.
   - The nature of the production processes.
   - The type or class of customer for their products and services.
   - The methods used to distribute their products.

J. Going Concern

1. That you have made us aware of any issues that are relevant to the Council's ability to continue as a going concern, including significant conditions and events, our plans for future action, and the feasibility of those plans.

K. Specific Representations

1. That there have been no significant changes to the Council's Private Finance Initiative schemes during 2012/13 and contractual arrangements, including any material variations, and the accounting model used are not significantly changed from the end of the last accounting period.

I would be grateful if you could provide a letter of representation, which is appropriately signed and dated on the proposed audit opinion date, on formal headed paper. The letter of representation should also be signed and dated by Councillor Leslie Hamilton as Chair of the Audit & Standards Committee.

Yours sincerely

Helen Thompson
Director
Ernst & Young LLP
United Kingdom