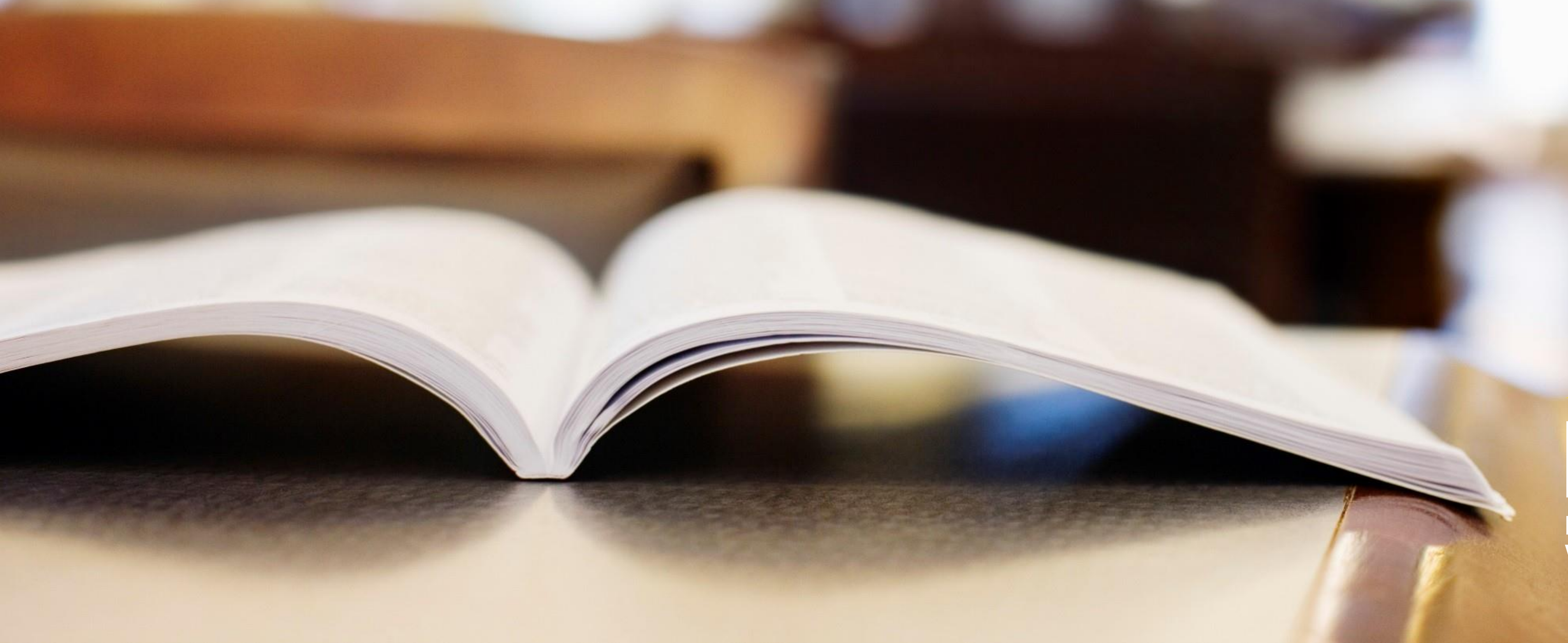
Brighton & Hove City Council

Annual Audit Letter for the year ended 31 March 2018

August 2018



Building a better working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a ‘Statement of responsibilities of auditors and audited bodies’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between 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 ‘Terms of Appointment (updated 23 February 2017)’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter 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.

01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to Brighton & Hove City Council (the Council) following completion of our audit procedures for the year ended 31 March 2018.
Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.
Reports by exception:	
► Consistency of Annual Governance Statement	The Annual Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 24 July 2018.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	We have not as yet issued our audit completion certificate. We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack. We also cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to conclude the objection to the Council's 2015/16 Statement of Accounts concerning the use of Lender Option Borrower Option (LOBO) loans. It is our view that even if the objection were resolved in the objector's favour, this would not have a material effect on the financial statements or on our value for money conclusion.

In December 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Paul King

Associate Partner

For and on behalf of Ernst & Young LLP

02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the July Audit & Standards Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued in January 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2017/18 financial statements, and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned 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.

03 Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 30 July 2018.

Our detailed findings were reported to the 24 July 2018 meeting of the Audit & Standards Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Management Override of Control 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 testing did not identify any evidence of management override of controls. • We did not identify any indication of management bias through our testing of accounting estimates; • We confirmed that assets and liabilities recognised in the financial statements were consistent with the PFI model; • We confirmed the PFI annual spend (unitary charge) agreed to the payments made to the contract for the year; • We confirmed the valuation of Property, Plant and Equipment was materially correct; • We did not identify any journal entries which contained evidence of management override of controls; and, • We have not identified any transactions which are outside the course of the Council's normal business. Overall, our audit work did not identify any material issues, in appropriate judgements or unusual transactions which indicated that management had overridden controls.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Authority's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	While our testing suggested the valuation of Land and Buildings as at 31 March 2018 was materially correct, we did identify one asset that had been revalued in year but had previously burnt down. The value of Land and Building was overstated by £2.839 million as a result. The financial statements were appropriately adjusted for this error. Otherwise, we completed those procedures outlined opposite and confirmed that: • The work performed by the Council's valuers was adequate and they had appropriate professional capabilities to complete the work; • Key asset information used by the valuers in performing their valuation was supported by evidence; • All Land and Building assets are included in the annual cycle of valuations such that they will be valued at least once every 5 years. We confirmed that other than the error highlighted above, we found no evidence that specific changes to assets that may have occurred had not been communicated to the valuer. • Those assets not subject to valuation will not result in the asset base being materially misstated as at 31 March 2018; • Useful economic lives were appropriate for those assets tested; and • Appropriate accounting entries had been posted to ensure the valuation was properly recorded in the financial statements.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Key Findings	Conclusion
Pension Liability Valuation In our Audit Planning Report we identified the Pension Liability Valuation as an area that was not a significant risk, but was an area of audit focus due to its complexity and size within the financial statements. The Authority's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2018 this totalled £257.2 million (2016/17: £254.9 million). The information disclosed is based on the IAS 19 report issued to the Council by the actuary to East Sussex County Council, the Administering Authority. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We completed a programme of work to provide assurance over the balance: • We liaised with the auditors of East Sussex Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Brighton & Hove City Council. At the time of presenting our audit results report to the Audit & Standards Committee, the auditors of East Sussex Pension Fund had not completed their audit and had not shared their final report with us. We subsequently received their initial report on 27 July, but this noted one assurance had not been received. We carried out alternative procedures to compensate for this absence, and were able to issue our audit report on 30 July. We subsequently received an updated, complete report from the Pension Fund auditors on 31 July. • We assessed the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considered findings from the EY actuarial team; and • Reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. As part of our the above procedures, the Pension Fund auditor compared the net fund assets estimated by the actuary at the year end to the actual net fund assets of the pension fund. The actuary estimated this as being £3,361,000,000 but the actual net fund assets of the pension fund are £3,377,700,000, giving a £14,700,000 variance. The IAS 19 pension figures included within the financial statements are based upon actuaries reports which use the estimated figure rather than the actual year end balance. While this approach is not unusual, given that this variance is significant, we calculated Brighton & Hove City Council's share of the net fund asset difference as being £4,511,793. This immaterial difference was not been adjusted within the financial statements. No other errors were identified.
Faster Close In our March 2018 progress report, we highlighted the Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. The timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July. We recognised that these changes provided risks for both the preparers and the auditors of the financial statements.	We are pleased to report that the Authority has met the required deadlines and has provided the information we require; principally: · good quality draft financial statements and supporting working papers by the agreed deadline; · appropriate Council staff to be available throughout the agreed audit period; and · complete and prompt responses to audit questions. We are therefore satisfied that the Council appropriately planned for and responded to the faster close agenda.

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £17.276 million (2016/17: £16.93 million), which is 2% of Gross Expenditure adjusted for non-cash items. We consider Gross Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit & Standards Committee that we would report to the Committee all audit differences in excess of £0.863m.

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits
- Related party transactions.

In both these areas we applied materiality of £1, matching the level of disclosure within the financial statements.

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

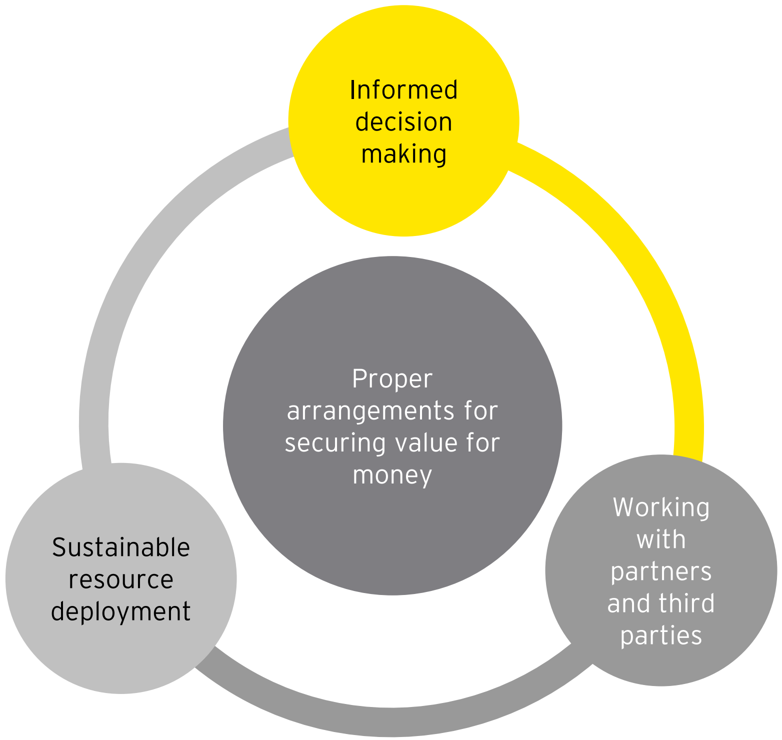
04 Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We identified one significant risk in relation to these arrangements. The tables below present the findings of our work in response to the risks identified and any other significant weaknesses or issues to bring to your attention.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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Value for Money (cont'd)

We issued an unqualified value for money conclusion on 30 July 2018.

Significant Risk – Securing Financial Resilience

Use of PSAA's value for money profile tool to assess Council spending against similar councils

We reviewed the VFM profiles, now held on the LGA website which compare the Council to other English unitary councils. This highlighted that Brighton & Hove City Council has a higher total net spend per head than the average English unitary, although the spend has been reducing in line with the national trend. This data showed that spend on Council tax and Housing Benefits was significantly higher than other English unitaries, but again there is a clear downward trend such that the 2015-17 figures are largely in line with others nationally. This provides some assurance that action is being taken to reduce costs in high spend areas.

The data also shows high spend in Children and Young People Services, Housing Services and Public Health Services. The reasons for the high spend in these areas reflects the demographic within the Council's boundary, although we note spend in these areas is also reducing in a similar trend to the national average.

We are therefore satisfied that a review of these statistics does not identify further risks to our Value for Money conclusion.

Reviewing and assessing the updated assumptions within the Council's 2017/18 budget and medium term financial plan:

The assumptions within the Councils 2017/18 budget and medium term financial plan continue to be based upon reasonable and supportable assumptions. As previously reported, the Council's Medium Term Financial Strategy (MTFS) 2015-2019 forecast a gross cumulative budget gap of some £102 million up to the end of 2019/20. The Council continues recognise that reserves cannot, and should not, be used to bridge the base budget gap in the absence of longer term plans to make the necessary savings and we note from the MTFS that there is no planned future use of reserves to address budget gaps, as highlighted on page 20. Further, a significant contribution was made to the Councils reserves in 2017/18 which while the Council does not plan on utilising to support revenue spend, does provide the Council with additional financial resilience in the medium to longer term.

The updated financial forecasts predict a budget gap of £15.036m for 2018/19 and £14.745m for 2019/20, and the Council expects to be able to make appropriate savings to balance the budget without drawing from reserves.

Reviewing and understanding the 2017/18 outturn position:

The Council's draft financial statements have been produced and report a year end Surplus on the Provision of Services of £5.162m. This figure is not directly comparable to the budgeted position due to the way the CIES discloses the income and expenditure and the fact that the budget is set on a directorate level. We have therefore also reviewed the EFA disclosure, which shows the income and expenditure in the same manner as the budget. This confirmed there was a surplus on the provision of services of £1.311m. The Council's total usable reserves as at 31 March 2018 remain healthy at £108.038m. This represents a significant increase of £36.466m compared to 31 March 2017, and we note reserves were not used to support the revenue position.

Reviewing forecast savings from the 4 year Service & Financial Plans and progress in meeting them:

The Council's Targeted Budget Management documentation confirms that in 2017/18, £17.203m of savings were achieved, representing 78% of the approved target. As with the prior year, there are areas that underperformed when compared to the budget, principally Children's and Adult Social Care, and Learning Disability Services.

We have reviewed the 2018/19 budget documentation and are satisfied that the saving requirements have been appropriately updated for the actual 2017/18 performance, and there continues to be ongoing monitoring and review of those savings requirements and plans to deliver them.

From completion of the above procedures, we are satisfied the Council has proper arrangements in place to deliver sustainable resource deployment in the medium term.

05 Other Reporting Issues

Other Reporting Issues

Reporting Issue	Findings
Whole of Government Accounts	We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.
Annual Governance Statement	We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading. We completed this work and did not identify any areas of concern.
Report in the Public Interest	We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public. We did not identify any issues which required us to issue a report in the public interest.
Written Recommendations	We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response. We did not identify any issues which required us to issue a written recommendation.
Objections Received	We did not receive any objections to the 2017/18 financial statements from members of the public.
Other Powers and Duties	We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.
Independence	We communicated our assessment of independence in our Audit Results Report to the Audit & Standards Committee on 24 July 2018. 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 regulatory and professional requirements.
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 control, we are required to communicate to you significant deficiencies in internal control identified during our audit. We have adopted a fully substantive approach and have therefore not tested the operation of controls. Our audit did not identify any controls issues to bring to the attention of the Audit & Standards Committee.

06 Data Analytics

Use of Data Analytics in the Audit

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the Council's audit included testing journal entries and employee expenses, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis
We obtain downloads of all of the Council's financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.

Payroll Analysis
We also use our general ledger analyser in our payroll testing. We analyse the data against a number of specifically designed procedures. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation.

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07 Focused on your future

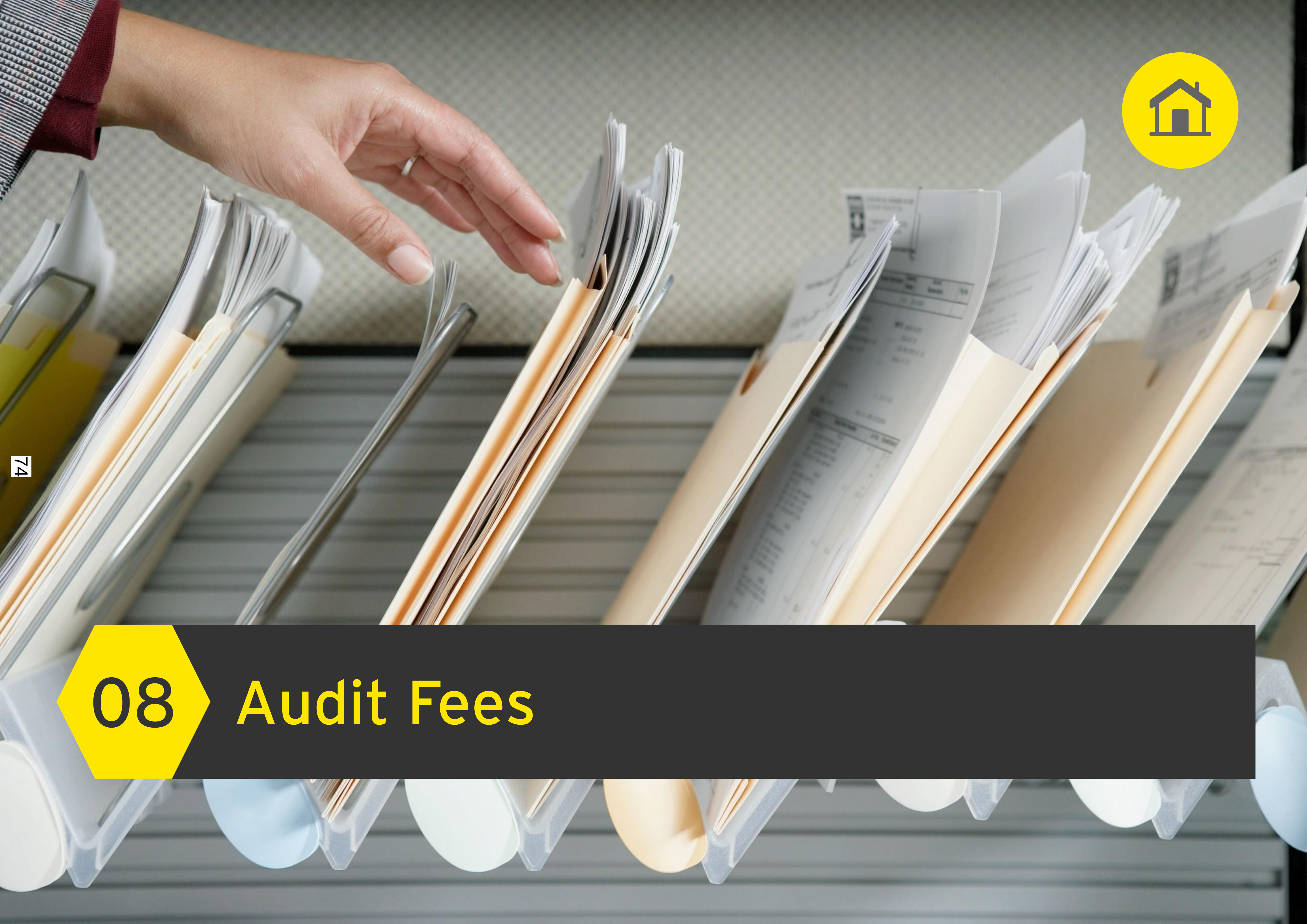
Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial assets. There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.	Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to: ▸ Reclassify existing financial instrument assets ▸ Re-measure and recalculate potential impairments of those assets; and ▸ Prepare additional disclosure notes for material items.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: ▸ Leases; ▸ Financial instruments; ▸ Insurance contracts; and ▸ For local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.	As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited. The standard is far more likely to impact on Local Authority Trading Companies who will have material revenue streams arising from contracts with customers. The Council will need to consider the impact of this on their own group accounts when that trading company is consolidated.

Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.



08 Audit Fees

Audit Fees

Our fee for 2017/18 is in line with the scale fee set by the PSAA and reported in our Audit Plan and Annual Results Report.

	Final Fee 2017/18	Planned Fee 2017/18	Scale Fee 2017/18	Final Fee 2016/17
	£	£	£	£
Total Audit Fee – Code work	**158,550**	**158,550**	**158,550**	**162,050**
Non-audit work [Grant claims]	16,957	16,957	16,957	13,898
Total fees	**175,507**	**175,507**	175,507	172,448

We note that additional fee will be charged in respect of the 2015/16 objection regarding the LOBO loans objection. We currently estimate this additional fee to be approximately £26,000 although this is subject to final completion and subsequent review and determination by PSAA.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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ED None

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