



The Annual Audit Letter for Bath and North East Somerset Council

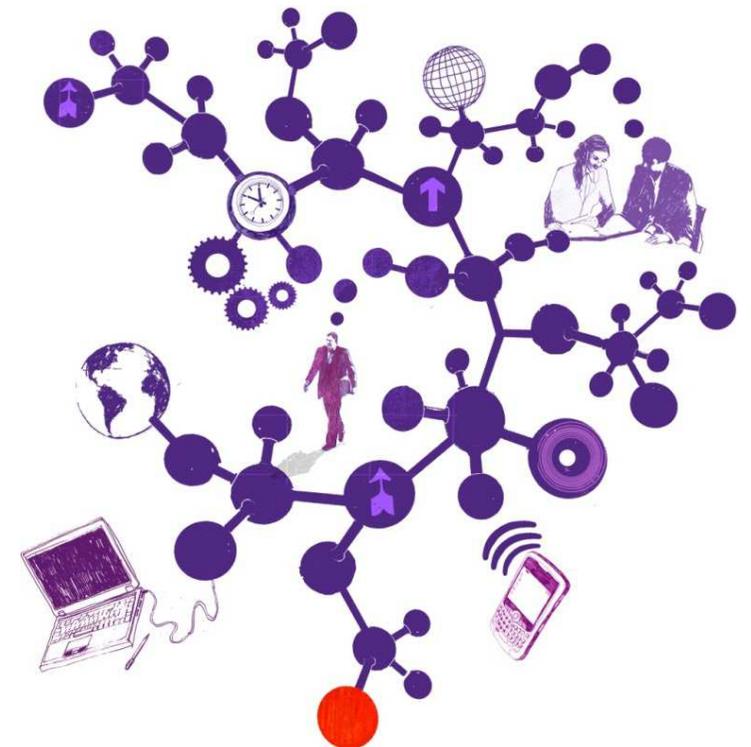
Year ended 31 March 2016

20 October 2016

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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Bath and North East Somerset Council for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Corporate Audit Committee as those charged with governance in our Audit Findings Report on 27 September 2016.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 27 September 2016.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit opinion on 21 September 2016.

Whole of government accounts

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 19 October 2016.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of Bath and North East Somerset Council as we have not given an audit opinion on the pension fund annual report.

Certification of grants

We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is complete, but hasn't been reported yet. We expect to certify the return by mid-November (deadline 30 November 2016). We will report the results of this work to the Corporate Audit Committee in our Annual Certification Letter.

Other work completed

We have provided two reporting accountant's reports on Regional Growth Fund expenditure. We have also completed the required work on the Teachers' Pension return.

Working with the Council

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
October 2016

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £7,300,000, which is 1.8% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for certain areas such as officers' remuneration, auditor remuneration and pooled budgets.

We set a lower threshold of £364,000, above which we reported errors to the Corporate Audit Committee in our Audit Findings Report.

Pension Fund

For the audit of the Avon Pension Fund accounts, we determined materiality to be £38,400,000, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a threshold of £1,900,000 above which we reported errors to the Corporate Audit Committee and Avon Pension Fund Committee.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts – Bath and North East Somerset Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of long term (non-current) assets</p> <p><i>Valuation of property plant and equipment</i></p> <p>The Council's property, plant and equipment, including its housing stock, represents 45% of its total assets. Their value is estimated by property valuation experts.</p> <p>The Council revalues these assets on a rolling basis.</p> <p><i>Valuation of surplus assets and investment property</i></p> <p>The Council changed the basis on which it valued surplus assets and investment property in 2015/16 because of the introduction of a new international financial reporting standard (IFRS 13). These assets represent 37% of the Council's total assets and their value is estimated by property valuation experts.</p> <p>The Council also needed to make changes to the disclosures for items valued at fair value under the new financial reporting standard.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • Reviewed management's processes and assumptions for the calculation of the estimate. • Reviewed the competence, expertise and objectivity of any management experts used. • Reviewed the instructions issued to valuation experts and the scope of their work • Discussed with the Council's valuer the basis on which the valuation was carried out, challenging the key assumptions. • Reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding. • Tested revaluations made during the year to ensure they were input correctly into the Council's asset register • Evaluated the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value. • Reviewed the disclosures made by the Council in its financial statements to ensure they were in accordance with the requirements of the CIPFA Code of Practice and, in relation to surplus assets and investment properties, IFRS 13. <p>We identified that as part of the valuation of land and buildings, the valuer undertakes a review of various indices to ascertain if there has been any significant change in value that would result in the current value at the year end being significantly different to the carrying value in the accounts. The valuer concluded that the movements were not material, based on the valuer's materiality of +/-10%, which is considerably higher than the materiality used in the accounts audit.</p> <p>Our review of indices suggested that other land and buildings were understated by around £8m and investment property by £13m. Given this, the Council also reviewed the available indices and has used them to amend the accounts, to reflect the increased values.</p> <p>The valuation on which the figures in the accounts are based was undertaken in accordance with RICS requirements. The use of indices in the financial statements, however, means that the Council has adopted a valuation method which is not consistent with the Code on Local Authority Accounting.</p> <p>It was also noted there were a number of disclosure notes that needed to be added to the financial statements in order to comply with the requirements of the CIPFA Code of Practice.</p> <p>We will continue to work with the Council's finance and valuation teams to identify a sustainable solution to the issue of valuation of its assets at fair value.</p>

Audit of the accounts – Bath and North East Somerset Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of pension fund net liability</p> <p>The Council's pension fund asset and liability, as reflected in its balance sheet, represents a significant estimate in the accounts and comprises 64% of its total liabilities.</p> <p>The value of the pension fund net liability is estimated by specialist actuaries.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none">• Documented and walked through the key controls that were put in place by management to ensure that the pension fund liability was not materially misstated.• Reviewed the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation.• Gained an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made.• Reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from the actuary. <p>We did not identify any issues to report.</p>

Audit of the accounts – Avon Pension Fund

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the pension fund.

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of level 3 investments Level 3 investments are those where there is no existing market and the valuation depends on matters that are more subjective. These represent 21% of the Pension Fund's total assets and their value is estimated by specialist valuers.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none">• Documented and walked through the key controls that were put in place by management to ensure that investments were not materially misstated.• Performed a triangulation exercise to confirm amounts reported in the financial statements to the custodian and fund manager confirmations.• Tested valuations by obtaining and reviewing the audited accounts at latest date for individual Level 3 investments and agreed these to the valuations used in the financial statements and used by the custodian. Where audited accounts were for a period ending before 31 March 2016 we reconciled those values to the values at 31 March with reference to known movements in the intervening period. Where audited accounts were unavailable we confirmed valuations to an independent external price source.• Reviewed the service auditor reports for Fund Managers and the custodian to provide assurance over the control environment at the service organisation. <p>We did not identify any issues to report.</p>

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 27 September 2016, in advance of the 30 September 2016 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a satisfactory set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Corporate Audit Committee on 27 September 2016.

Other than the valuation issues referred to on page 6, we did not identify any significant adjustments to report to the Corporate Audit Committee. We did, however, report unadjusted misstatements in relation to unrecorded liabilities i.e. payments in 2016/17 that related to goods/services received in 2015/16 and creditors, where the available evidence did not fully support the figure in the accounts.

Pension fund accounts

We also reported the key issues from our audit of accounts of the Pension Fund hosted by the Council to the Council's Corporate Audit Committee on 27 September 2016. No significant issues were identified during our audit.

Annual Governance Statement and Narrative Report

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO. We issued a group assurance certificate which did not identify any issues for the group auditor to consider.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risk we identified and the work we performed is set out overleaf.

Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

Value for Money

Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Medium term financial plan The Council has undertaken a detailed strategic review, from which the medium term financial plan was developed. However, as a result of the financial settlement announced in November 2015, the Council now has to identify a further £10m of savings or additional income over the period covered by the medium term financial plan i.e. four years.</p>	<p>We reviewed the Council's arrangements for compiling and agreeing its budget and medium term financial plan. We considered the assumptions made and the extent to which scenario analysis was employed. We also reviewed the actions being taken to address the shortfall arising from the financial settlement announced in November 2015.</p>	<p>The Council has a good record of delivering its financial plans. For 2015/16, the Council reported an underspend of £659,000.</p> <p>In setting the 2016/17 budget, a number of assumptions were made for both income and expenditure. We have assessed the reasonableness of these assumptions, such as inflation, interest rates and grant funding, and consider that they are appropriate given the underlying information.</p> <p>Savings plans have been developed for 2016/17 and beyond. These plans are regularly monitored and updated. We reviewed a number of the savings plans and consider them to be adequately supported by the underlying evidence. However, the report underpinning the increase in commercial property income notes that there is a "high degree of uncertainty attaching" to various elements of the plan including the acquisition of income producing investment properties.</p> <p>It is clear that the Council is considering the alternatives available to it to secure the financial position in the medium to long term. A good example of this is the setting up of the property company, Aqueus. Consideration is also being given to which services may need to be reduced or stopped or where additional income can be derived. In essence, all options are being considered.</p> <p>There are no significant issues arising from the work that we have undertaken to address the risks identified in the risk assessment, although the forecast growth in commercial property income, may need to be revisited to ensure that the assumptions made are still appropriate. It is clear that the Council has undertaken a significant amount of work to prepare a robust medium term financial plan. These plans then had to be revisited, due to the worse than expected financial settlement, but the groundwork completed in developing the initial plans positively supported this subsequent review.</p> <p>As a result of the financial settlement, a further £3m of savings has been identified for 2016/17 financial year, and a further £20m has had to be identified for 2017/18 onwards. Work is already underway to identify the £20m and the Council is also considering the impact of the vote to leave the European Union.</p>

Working with the Council

Our work with you in 2015/16

We are really pleased to have worked with you over the past year and we have continued to maintain a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness.

Sharing our insight – we provided regular updates to the Corporate Audit Committee covering best practice. Areas we covered included Innovation in public financial management, Knowing the Ropes – Audit Committee; Effectiveness Review, Making devolution work, Reforging local government. We have also shared with you our insights on advanced closure of local authority accounts, in our publication "Transforming the financial reporting of local authority accounts" and will continue to provide you with our insights as you bring forward your production of your year-end accounts.

Thought leadership – We have shared with you our publication on Building a successful joint venture and will continue to support you as you consider greater use of alternative delivery models for your services

Providing training – we provided training on financial accounts and pooled budgets. The workshops were attended by members of your finance team.

Providing information – We demonstrated CFO insights, our on-line analysis tool providing you with access to insight on the financial performance, socio-economy context and service outcomes of councils across the country.

Support outside of the audit – our advisory team supported you in developing a tool to assess developments being considered by the new housing and development company, Aequus.

Working with the Council

Working with you in 2016/17 Highways Network Asset

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

The nature of these changes means that the finance team will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have issued two Client Briefings which we have shared with Divisional Director: Business Support. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, so we have already had some preliminary discussions with the Council to assess the progress it is making in this respect. Our discussions with Council Officers to date has highlighted the following:

- In accordance with LAAP Bulletin 100 "Project Plan for Implementation of the Measurement Requirements for Transport Infrastructure Assets by 2016/17", the valuation model has been completed for 2015/16 and the value disclosed in the 2015/16 financial statements narrative report.
- Valuations for 2016/17 are underway and the accounting entries determined.
- Atkins have been engaged as consultants as specialists in highways modelling and will be retained for future guidance. A cross service working group is in place across Finance and Highways Services to ensure suitable procedures are in place to ensure that asset information is up to date and accurate.
- The Council is working through a programme of improvements, suggested by Atkins, to improve data accuracy.

Working with the Council

We will continue to liaise closely with the senior finance team during 2016/17 on this important accounting development, with timely feedback on any emerging issues.

The audit risks associated with this new development and the work we plan to carry out to address them will be reflected in our 2016/17 audit plan.

We will also continue to work with you and support you over the next financial year.

Locally our focus will be on delivering an efficient audit and helping the Council towards early close of the accounts, as a dry run for 2017/18 when the deadline for preparation of the draft accounts is brought forward from 30 June to 31 May.

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and provision of non-audit services.

Fees

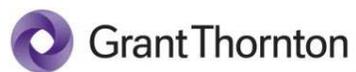
	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Council	123,832	123,832	165,109
Statutory audit of Pension Fund	28,805	28,805	28,805
Housing Benefit Grant Certification	16,760	16,760	18,340
Total fees (excluding VAT)	169,397	169,397	212,254

Fees for other services

Service	Fees £
Audit related services:	
• Regional growth fund (reporting accountant's report)	6,120
• Teacher's pension return (reporting accountant's report)	4,200
Non-audit services	
• Financial modelling for DevCo	42,000

Reports issued

Report	Date issued
Audit Plan	March 2016
Audit Findings Report	September 2016
Annual Audit Letter	October 2016



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