

Annual Audit Letter

Scarborough Borough Council

For the year ended 31 March 2017



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Executive summary

Purpose of this report

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Scarborough Borough Council ('the Council') for the year ended 31 March 2017. Although this letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 ('the 2014 Act') and the Code of Audit Practice issued by the National Audit Office ('the NAO'). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of work	Summary
Financial statements opinion	<p>We are yet to finalise the opinions on the financial statements for 2015/16 and 2016/17.</p> <p>As part of our audit of the Council's accounts for 2015/16 we received a statutory objection under the Local Audit and Accountability Act 2014 by an elector. The objection challenged the accounting treatment of income and expenditure in relation to harbour activities in Whitby. The audit implications of the objection, which need to be considered fully before we can issue an opinion on the accounts for 2015/16 and 2016/17, have not yet been determined and we are considering the legal advice we have obtained on the matter. In August 2017 we received an objection to the Council's accounts for 2016/17 on a related matter.</p> <p>Other than the above, the audit progressed smoothly with only a small number of errors identified. The matters identified in the audit are set out in more detail in section 2.</p>
Value for Money conclusion	<p>We carried out our work in line with updated National Audit Office guidance. As was the case during last year's audit and given the outstanding objection we were not in a position to issue a value for money conclusion by the 30 September 2017.</p>
Whole of Government Accounts	<p>As our audit opinion has not been issued we have been unable to conclude our work on your Whole of Government Accounts return. This work will be completed when our opinion is issued.</p>
Matters that we report by exception	<p>We have not identified any matters to report in relation to:</p> <ul style="list-style-type: none"> • whether the Annual Governance Statement is in line with our understanding of the Council and the requirements of the Delivering Good Governance in Local Government Framework 2016; or • reports in the public interest or written recommendations made under s24 of the 2014 Act. <p>We have been asked to exercise the audit powers we have under the 2014 Act as part of an objection which is challenging the accounting treatment the Council applies to Whitby Harbour. We have not completed our work on this matter.</p>

Audit of the financial statements

Financial statements opinion

Not Completed subject to completion of work on the objection to the accounts

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Council and whether they give a true and fair view of the Council's financial position as at 31 March 2017 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing for the UK and Ireland (ISAs). These require us to consider whether:

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

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its

misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2017:

Financial statement materiality	£1.4m
Specific materiality	We have applied a lower level of materiality to the following items of account: <ul style="list-style-type: none">• Senior officer remuneration• Exit packages• Members Allowances
Trivial threshold	£46,000

Our response to significant audit risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Significant risk	How we addressed the risk	Audit Conclusion
<p>Management override of control In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such overrides could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.</p>	<p>We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> • material accounting estimates affecting amounts included in the financial statements; • consideration of identified significant transactions outside the normal course of business; and • journals recorded in the general ledger and other adjustments made in preparation of the financial statements. 	<p>Our audit work provided the assurance we sought and did not highlight any issues in this area to report.</p>
<p>Revenue Recognition Auditing standards include a rebuttable presumption that there is a significant risk in relation to the timing of income recognition and in relation to judgements made by management as to when income has been earned. Mazars' policy is that the scope to apply such a rebuttal is limited. As there is an inherent risk of fraud in revenue recognition we consider it to be a significant risk on all audits. This does not imply that we suspect actual or intended manipulation but that we continue to approach the audit with due professional skepticism.</p>	<p>We evaluated the design and implementation of controls to mitigate the risk of income being recognised in the wrong period. In addition, we undertook a range of substantive procedures including:</p> <ul style="list-style-type: none"> • testing income in March, April and May 2017 to ensure they have been recognised in the right year; • testing adjustment journals; and • obtaining direct confirmation of year-end bank balances and testing the reconciliations to the ledger. 	<p>Our audit work provided the assurance we sought and did not highlight any issues in this area to report.</p>

Identified Significant Risks (Continued)

Significant risk	How we addressed the risk	Audit conclusion
<p>Pension Estimates (IAS19) The financial statements contain material pension entries in respect of retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.</p>	<p>We discussed any significant changes to the pension estimates. In addition to our standard program of work we:</p> <ul style="list-style-type: none"> evaluated the management controls you have in place to assess the reasonableness of the figures provided by the actuary; and considered the reasonableness of the actuary's output, referring to an expert's report on all actuaries nationally which is commissioned by the National Audit Office. 	<p>Our audit work provided the assurance we sought and did not highlight any issues in this area to report.</p>
<p>Whitby Harbour We reported to you in our Annual Audit Letter for work on the 2015/16 accounts we had received a formal objection from a local elector over income and expenditure in relation to activities in Whitby Harbour. This has proven to be a complex matter and has yet to be resolved. The status of the Harbour has required the Council to seek detailed legal advice. Until this is resolved we are not in a position to determine the financial impact on the 2015/16 or 2016/17 accounts and certify completion of the audits for 2015/16 or 2016/17.</p>	<p>We are considering the objection in line with our statutory responsibilities under the Local Audit and Accountability Act 2014. We are reviewing the detailed legal advice received by the Council and are considering the conclusions from our own legal advisors over the applicability of the Whitby Harbour Act 1905 and its implications. We have also held a number of detailed discussions with the Council's Section 151 Officer and the Monitoring Officer. In August 2017 a further objection was received on a related matter in respect of the Council's accounts for 2016/17. We should be in a position to determine this objection when the legal position on the 2015/16 objection has been resolved.</p>	<p>We are considering the legal opinions of the Council and our own legal advisors on the applicability of the Whitby Harbour Act 1905 and the implications for the Council's accounts.</p>

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements but this did not extend to us expressing an opinion on the effectiveness of internal controls. We identified the following deficiencies in internal control as part of our audit.

Asset Register administration	<p>The Council successfully introduced a new asset register during 2016/17. This system is used to generate the accounting transactions and the Property Plant and Equipment (PPE) disclosures. We identified a number of administration errors on the asset register resulting in a number of trivial errors. There is a risk that more significant errors could occur in future if controls are not strengthened: We noted:</p> <ul style="list-style-type: none">• for assets revalued in year, the remaining life has not been updated in the asset register;• testing of finance leases identified one asset on the asset register recorded as buildings when it should have been land; and• when assets are being revalued all movements are being accounted for on the building element only and land is not being adjusted. Of the six revaluations tested, the land value for four had not been recognised. This this resulted in depreciation being over charged in year by £13,000. Further testing of all such transactions by the Council identified a total error of £19,000.
Potential effects	Misstatement of the values reported for PPE.
Recommendation	The Council introduces specific controls to address the control deficiencies.
Management response	Agreed - implement by December 2017.

Value for money (VFM) conclusion

Value for Money conclusion

Not Completed subject to completion of work on the objection to the accounts

Summary of our work

We are required to form a conclusion as to whether the Council made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

The following table provides commentary of our findings in respect of each of the sub-criteria and an indication as to whether proper arrangements are in place.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<p>The Council has a Constitution which is subject to regular review and which clearly details the governance structure of the Council. Regular reports on financial and operational performance are reported during the year to Cabinet and the year-end position is not significantly different to that forecast during the year. The Council's Financial Strategy identifies risks and overall risk management arrangements are in place to manage the risks the Council faces.</p> <p>Performance measures are linked to the Council's corporate planning process and the Council has a comprehensive Internal Audit plan and Internal Audit provide reports at each Audit Committee meeting.</p>	Yes

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment	<p>Financial and performance reports record a history of achieving financial targets. The Financial Strategy covers a five year period and is updated to reflect funding settlements. The Strategy is reviewed and updated, as a minimum on an annual basis and is designed to ensure the Council has sufficient resources to achieve the agreed aims and priorities.</p> <p>The Financial Strategy includes reasonable assumptions and identifies the financial pressures the Council will face in coming years. The Financial Strategy clearly sets out the savings the Council will need to achieve in the future. Whilst the Council has a good record of achieving its budgets, including challenging savings levels, there is recognition that delivering these savings will be a significant challenge and risk to the Council.</p> <p>The Council has Human Resources policies and procedures in place. There is a Transformational Programme that is intended to support the Council's budget pressures in the coming years. The arrangements are intended to help the Council identify potential efficiencies but also ensure the services delivered meet the needs of the service users in an increasingly digital world.</p>	Yes
Working with partners and other third parties	<p>The Council has a track record of working with partners. Reporting on significant partnerships is incorporated into the Corporate Performance Management Framework. The Audit Committee receive an annual assessment of all major partnerships.</p> <p>The Council's Constitution details the arrangements for contracting with third parties.</p>	Yes

Significant Value for Money audit risk

As part of our continuous planning processes, we carry out work to identify whether or not a risk to the VFM conclusion exists. In our Audit Strategy Memorandum, we reported that we had identified one significant VFM audit risk. The work we carried out in relation to significant risks is outlined below.

Value for money conclusion risk

Sustainable resource deployment – financial resilience

The Council continues to face significant financial pressure and reductions in central government funding.

Work undertaken and findings

We reviewed:

- the Medium Term Financial Plan, including assumptions made;
- budget monitoring reports and other finance updates; and
- arrangements to deliver future savings, including review of 17/18 savings plans.

Conclusion

The Council has established arrangements for financial planning, budget monitoring and risk management. Usable general and earmarked reserves have increased over the past 3 years from £20.8m in 14/15 to £23.6m in 15/16 and £29.4m in 16/17 with small yearly under-spending of £0.1m, £0.8m and £0.6m over the same periods. Whilst most of these reserves are committed to future capital projects and revenue spending, this demonstrates the Council's delivery of its financial plan and a stable financial position. The Council continues to make prudent assumptions about the delivery of savings plans, additional costs and future income in the development of its financial plans. The assumptions in the Council's 17/18 revenue financial plan include savings targets and additional future costs such as inflation.

The Council's revenue and budget monitoring reports are considered by budget holders each month. Savings targets are built into budgets so any failure to achieve the financial target should be highlighted in variance reports. This system has successfully delivered savings in previous years. Delivery of savings is supported by the Council's service review or Transformation Programme, which assisted in generating additional income in 2016/17 such as improving income recovery for trade refuse. The Council has requested outside assistance through the Local government Association (LGA) peer review process looking at the Estates department the Council is looking to address the recommendations.

Completing major projects is a significant risk to the Council because of their scale, the arrangements needed to support them, and the level of financial risk involved. In 2016/17 and early 2017/18 the Council delivered 2 major schemes: the Market Re-development; and the Sports Village. There was some slippage with capital schemes partly as a consequence of the nature of the schemes such as coastal protection which requires detailed planning before commencement. Each key project is managed by an overall board, and there are plans in 2017/18 to introduce an overall programme board and more formalised arrangements in the scheme project boards by recording meetings.

Other reporting responsibilities

Exercise of statutory reporting powers	We are currently considering an objection to the 2015/16 2016/17 Accounts on Accounting for Whitby Harbour Income
Annual Governance Statement	No matters to report
Whole of Government Accounts consistency with the financial statements	Consistent but yet to be complete due to the objection
Other information published alongside the financial statements	No matters to report

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters which we report by exception

The 2014 Act provides us with specific reporting powers where matters come to our attention that require reporting to parties other than the Council.

We have the power to:

- report in the public interest; and
- make statutory recommendations to the Council, which must be responded to publicly.

In addition we must respond to any objections or questions on items contained within the accounts raised by a local government elector. Our work on the objection to the accounting treatment applied to Whitby Harbour is on-going and is described on page 6 of this report.

We are also required to report if, in our opinion, the Annual Governance Statement does not comply with the guidance issued by CIPFA in 'Delivering Good Governance in Local Government; Framework 2016' or is inconsistent with our knowledge and understanding of the Council.

We did not exercise any of our reporting powers during our 2016/17 audit and had no matters to report to the Council in relation to the Annual Governance Statement.

Reporting to the NAO in respect of Whole of Government Accounts

The NAO requires us to report to them whether consolidation data that the Council has submitted is consistent with the audited financial statements, and to undertake specified procedures on that data. **We are unable to complete this working pending completion of our work on the objection over the accounting treatment for Whitby Harbour income.**

Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the information in the Narrative Report is consistent with the audited financial statements.

Our fees

Fees for work as the Council's appointed auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the audit committee in June 2017. Having completed our work for the 2016/17 financial year, we can confirm that our final fees are as follows:

Area of work	2016/17 proposed fee	2016/17 final fee
Code audit work	£52,200	£52,200
Certification of Housing Benefit Subsidy Claim	£16,035	£10,626

We confirm that these fees are in line with the scale fee set by Public Sector Audit Appointments Ltd except for Housing Benefit.

Whilst the Housing Benefit Subsidy certification scale fee in 2016/17 was £16,035 we have charged the 2015/16 fee of £10,626 because there was no increased risk and we did not carry out any additional work in 2016/17.

Fees for non-PSAA work

In addition to the fees outlined above in relation to our appointment by PSAA, we have been separately engaged by the Council to carry out additional work as outlined in the table below. The limit on non-audit fees in any single year under the PSAA Ltd contract is a maximum of 2% of the audit fee or £18,000 (plus VAT). For the Council the limit is therefore £18,000 plus VAT.

Area of work	2016/17 proposed fee	2016/17 final fee
Whistle-blowing investigation	£14,000	£14,000
VAT work on the crematoria	£2,200	£2,200
Vat Helpline	£1,000	£1,000
Total	£17,200	£17,200

Future challenges

Financial outlook

The main challenge we see for the Council, along with others and the wider public sector, is the continued pressure on finances and the need to plan for further reductions in spending power which will make it increasingly difficult to maintain the existing level service provision. We have noted how the Council has dealt with this challenge so far and expect there will be a need for difficult decisions to keep spending within available resources. **The Council's Medium Term Financial Plan includes a funding gap of £4.9m in the 4 years from 2018/19 to 2021/22. While** considerable progress has been made to address this gap, financial pressures are likely to continue into the foreseeable future.

Key to achievement of the savings required will be delivery of the Transformation Programme and embedding the changes needed so the Council can deliver achieve its goals and deliver essential services sustainably.

Operational challenges

To deliver the Council's plan for a prosperous Borough with a high quality of life, stretching targets have been set. Achieving these targets will require the Council to maintain a stable financial position and also successfully complete key projects that include

- **coastal protection schemes such as those at Whitby to repair the Harbour Wall and Scarborough South Cliff stabilisation;**
- **developments with private sector partners such as the Sands and the Middle Deepdale housing scheme; and**
- **the Futurist development on the Scarborough Sea front.**

The Council will need to continue to ensure strong project management arrangements are in place for these key projects.

How we will work with the Council

We will focus our 2017/18 audit on the risks that these challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money. We will also share with you relevant insights that we have as a national and international accounting and advisory firm with experience of working with other public sector and commercial service providers.

In terms of the technical challenges that officers face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise.

A key focus in the coming year will be working with officers to prepare for the earlier accounts and audit timetable which will take effect for the 2017/18 financial year. The Council will be required to produce the accounts by 30 May, rather than 30 June. The audit deadline will move from 30 September to 30 July. We will continue to work with officers to help ensure the Council is ready for this change.