



CAMBRIDGESHIRE COUNTY COUNCIL AND PENSION FUND

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2017
30 October 2017



EXECUTIVE SUMMARY

PURPOSE OF THE LETTER

This Annual Audit Letter summarises the key issues arising from the work that we have carried out in respect of the year ended 31 March 2017. It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public. It will be published on the website of Public Sector Audit Appointments Limited.

RESPONSIBILITIES OF AUDITORS AND THE COUNCIL

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's (NAO's) Code of Audit Practice (the Code), and to review and report on:

- The Council and Pension Fund financial statements
- Whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are also required to report where we have exercised our statutory powers under the Local Audit and Accountability Act 2014 in any matter.

We recognise the value of your co-operation and would like to take this opportunity to express our appreciation for the assistance provided during the audit.

BDO LLP
30 October 2017

AUDIT CONCLUSIONS

FINANCIAL STATEMENTS

We issued our unmodified true and fair opinion on the Council and Pension Fund financial statements on 12 October 2017.

Our audit identified material misstatements relating to both the recognition of grant income and presentation of items in the cash flow statement. We reported our detailed findings to the Audit and Accounts Committee on 19 September 2017 with subsequent updates on 3 October and 11 October 2017.

We reported on uncorrected misstatements which management and the Audit Committee concluded were immaterial.

USE OF RESOURCES

We issued our unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 12 October 2017.

EXERCISE OF STATUTORY POWERS

We received an objection regarding the lawfulness of certain transactions included in the financial statements and decisions made by the Council.

This work remains on going although we were satisfied that these matters did not have a material effect on the financial statements or on our value for money conclusion.

FINANCIAL STATEMENTS

OPINION

We issued our unmodified true and fair opinion on the Council and Pension Fund financial statements on 12 October 2017.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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

This includes an assessment of whether the accounting policies are appropriate to the Council and Pension Funds' circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates, and the overall presentation of the financial statements.

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

Our audit was scoped by obtaining an understanding of the Council and Pension Fund and their environments, including the systems of internal control, and assessing the risks of material misstatement in the financial statements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	OUTCOME
<p><u>Management override of controls (Council and Pension Fund)</u></p> <p>Management override of controls is present in all entities and require us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual.</p> <p>By its nature, there are no controls in place to mitigate the risk of management override.</p>	<p>Our response to this risk included:</p> <ul style="list-style-type: none"> testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements reviewing accounting estimates for biases and evaluating whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud obtaining an understanding of the business rationale for significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual. <p>Our audit work in relation to journals did not identify any significant issues.</p> <p>We did not find any indication of management bias in accounting estimates.</p> <p>No unusual or transactions outside of the normal course of business were identified.</p>	<p>No issues to report.</p>

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	OUTCOME
<p><u>Revenue Recognition (Council)</u></p> <p>Under auditing standards there is a presumption that income recognition presents a fraud risk.</p> <p>In particular, we considered there to be a significant risk in respect of the recognition of grants that are subject to performance and / or conditions before these may be recognised as income by the Council.</p> <p>We also considered there to be a significant risk in relation to the existence of fees and charges and investment rental income.</p>	<p>We tested a sample of grants subject to performance and / or conditions to confirm that conditions of the grant had been met before the income was recognised in the Council's financial statements.</p> <p>We tested an increased sample of fees and charges to ensure the income had been recorded in the correct period.</p> <p>We identified that £8.194million of intracompany income generated by providing services to schools had been incorrectly recognised in the comprehensive income and expenditure statement (CIES).</p> <p>Our review of the treatment of the grant income associated with the City Deal arrangement identified that grant income of £100m should have been recognised in full in the Council's CIES in 2015/16 when the grant was awarded. Further details regarding the City Deal arrangement are included on page 6.</p>	<p>Management corrected the errors identified in relation to these matters in the final financial statements.</p>
<p><u>Property, plant and equipment valuations (Council)</u></p> <p>Local authorities are required to ensure that the carrying value of property, plant and equipment (PPE) is not materially different to the fair value at the balance sheet date.</p> <p>The Council has engaged a new external valuer for 2016/17. There is a risk over the valuation of land and buildings where valuations are based on assumptions which are different from those applied in the prior year.</p>	<p>We reviewed the instructions provided to the valuer and reviewed the valuer's skills and expertise in order to determine if we could rely on the management expert. We were satisfied that the valuation had been undertaken in accordance with the relevant guidance.</p> <p>We confirmed that the basis of valuation for assets valued in year was appropriate based on their usage.</p> <p>We reviewed the movements in valuations with other relevant market indices to assess the reasonableness of the valuations.</p> <p>We were satisfied that the information provided to the valuer by the Council relating to those assets subject to revaluation was appropriate and that the revaluation movements had been accounted for correctly.</p> <p>We were satisfied that the assumptions and valuation bases used in the valuation exercise were reasonable.</p>	<p>No issues to report.</p>

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	OUTCOME
<p><u>Pension liability assumptions (Council)</u></p> <p>The net pension liability comprises the Council's share of the market value of assets held in the Cambridgeshire Pension Fund and the estimated future liability to pay pensions.</p> <p>An actuarial estimate of the Pension Fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate is based on the most up to date membership data held by the Pension Fund and has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation when calculating the liability.</p> <p>There is a risk the valuation is not based on accurate membership data or uses inappropriate assumptions to value the liability in the financial statements.</p>	<p>We agreed the disclosures to the information provided by the Pension Fund actuary.</p> <p>We reviewed the reasonableness of the assumptions used by the Pension Fund actuary. We have used the PwC consulting actuary report commissioned by the NAO on behalf of all local authority auditors for the review of the methodology of the actuary and reasonableness of their assumptions.</p> <p>We agreed the disclosures to the report received from the actuary.</p>	<p>No issues to report</p>

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	OUTCOME
<p><u>Valuation of investments (Pension Fund)</u></p> <p>The Pension Fund investment portfolio includes unquoted investment holdings valued by the fund manager. The valuation of these assets may be subject to a significant level of assumption and estimation and valuations may not be based on observable market data.</p> <p>In some cases, the valuations are provided at dates that are not coterminous with the Pension Fund's year end and need to be updated to reflect cash transactions (additional contributions or distributions received) since the latest available valuations.</p> <p>As a result, we considered there to be a significant risk that investments are not appropriately valued in the financial statements.</p>	<p>We have obtained direct confirmation of investment valuations from the fund managers.</p> <p>Where the financial statement date supporting the valuation is not coterminous with the Pension Fund's year end, we have confirmed that the appropriate adjustments have been made to the valuations in respect of additional contributions and distributions with the funds.</p> <p>We have reviewed the methods and assumptions used and considered whether investments have been correctly valued in accordance with relevant accounting policies.</p> <p>We have reconciled the valuations to direct confirmations from the investment managers and reviewed the basis used to value these.</p>	<p>We concluded that the valuation basis used appears reasonable and the values are not materially misstated.</p> <p>We identified an immaterial variance arising from the fact that some investment reports used during the preparation of financial statements were not coterminous with year-end.</p>

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	OUTCOME
<p><u>Grant received in relation to City Deal (Council)</u></p> <p>In response to audit recommendations made last year, the Council reviewed conditions associated with grant income recognised. Following this exercise, the Council concluded that there were no unsatisfied conditions associated with the City Deal grant income.</p> <p>We considered there to be a risk in respect of the completeness, existence and accuracy of the amounts recognised in respect of City Deal funding.</p>	<p>We obtained and reviewed the grant letter from the Treasury and the grant agreement document to establish whether or not there are any conditions or restrictions associated with the City Deal grant funding.</p> <p>During the audit we challenged the Council's accounting treatment of the City Deal grant income. After further consideration, the Council concluded that the Greater Cambridge Partnership Executive Board is responsible for deciding how the City Deal grant income is used. Therefore, the Council concluded that the Executive Board has control of the grant funding.</p> <p>Our review of the arrangements between the Executive Board and the Council confirmed that it is clear that the expectation of the Executive Board is that the grant funding will be spent by the Council on infrastructure projects approved by the Executive Board (hence the Council is also acting as the scheme promoter with responsibility for delivering each of the infrastructure schemes within the City Deal programme). This expectation transfers control of the grant to the Council.</p> <p>Accounting guidance requires that grants should be recognised immediately as income unless any conditions have not been met. The Council concluded that the City Deal grant income awarded in 2015/16 had some restrictions but did not have any stipulations attached to it that constituted conditions regarding its use. The Council has therefore recognised a prior period adjustment to account for the £100m of grant income in 2015/16. We reviewed the revised accounting treatment and concurred with the Council's judgements and revised treatment.</p>	<p>Management corrected the identified error of £100m in the final financial statements.</p>
<p><u>Treatment of revenue expenditure funded from capital under statute (REFCUS) (Council)</u></p> <p>In the prior year, our audit identified that the value of REFCUS transactions were being netted off against net cost of services income and expenditure in the CIES.</p> <p>The introduction of the new layout of the CIES and the resulting changes in the presentation of income and expenditure increase the risk that REFCUS transactions may be incorrectly accounted for in the current year.</p>	<p>We tested a sample of REFCUS transactions to confirm that they were correctly recognised and presented in the CIES.</p> <p>Our testing of a representative sample of REFCUS transactions recognised in the draft financial statements identified transactions relating to expenditure on assets owned by the Council. These transactions do not meet the definition of REFCUS.</p> <p>Further work was undertaken by the Council to identify all transactions affected by this error. We tested a sample of these transactions to confirm that they had been incorrectly classified as REFCUS.</p> <p>REFCUS transactions with a value of £9.053 million were reclassified as impairments in the draft financial statements.</p>	<p>Management corrected the error identified in the final financial statements.</p>

FINANCIAL STATEMENTS

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit and in evaluating the effect of misstatements.

We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonably knowledgeable users that are taken on the basis of the financial statements.

Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

The materiality for the Council's financial statements as a whole was set at £16.5 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 1.75 per cent) which we consider to be one of the principal considerations for the Council in assessing the financial performance.

The materiality for the Pension Fund's financial statements as a whole was set at £28.5 million. This was determined with reference to a benchmark of net assets (of which it represents 1 per cent) which we consider to be one of the principal considerations for the Pension Fund in assessing the financial performance.

We agreed with the Audit and Accounts Committee that we would report all individual audit differences in the Council's financial statements in excess of £330,000 and those in the Pension Fund financial statements £540,000.

AUDIT DIFFERENCES - COUNCIL

Our audit found the following material audit differences that were corrected in the financial statements:

- A prior period adjustment to recognise grant income of £100m associated with the City Deal arrangement
- Prior period adjustments to recognise the correct cash flows associated with grants for financing capital expenditure (misstated by £170.3million) and capital grants received through investing activities (£136.8million)

- Current year adjustments to recognise the correct cash flows associated with grants for financing capital expenditure (misstated by £150.7m) capital grants received through investing activities (£168.4million).

In addition we found five audit differences which remained uncorrected in the final financial statements as follows:

- £710,000 arising from unadjusted misstatements identified in the prior period in the relation to expenditure accruals
- £6.047 million understatement of the net Pension Fund liability
- Net £3.759 million overstatement of liabilities (combination of two audit differences arising)
- £399,000 understatement of expenditure

Correcting for these remaining misstatements would have resulted in the Council reporting a £1.508 million lower deficit for the year.

We consider that these uncorrected misstatements did not have a material impact on our opinion on the financial statements.

AUDIT DIFFERENCES - PENSION FUND

Our audit did not identify any material misstatements.

Our audit identified two audit differences not corrected in the final financial statements as follows:

- £600,000 understatement arising from the omission of accrued contributions
- £6.5 million understatement of investment balances.

Correcting for these misstatements would have resulted in the Pension Fund reporting a £7.12million higher net increase in the net assets available for benefits during the year.

We consider that these uncorrected misstatements did not have a material impact on our opinion on the Pension Fund's financial statements.

FINANCIAL STATEMENTS

OTHER MATTERS WE REPORT ON

Narrative report

The information given in the narrative report in the Statement of Accounts for the financial year was consistent with the financial statements.

Annual governance statement

The annual governance statement meets the disclosure requirements set out in the guidance 'Delivering Good Governance in Local Government: Framework' (2016 edition) published by CIPFA/SOLACE and was not misleading or inconsistent with other information that is forthcoming from the audit.

INTERNAL CONTROLS

We did not find any significant deficiencies in internal controls during the course of our audit. A number of other areas for improvement were identified which we have discussed with management.

WHOLE OF GOVERNMENT ACCOUNTS

Auditors are required to review Whole of Government Account (WGA) information prepared by component bodies that are over the prescribed threshold of £350 million in any of: assets (excluding certain non-current assets); liabilities (excluding pension liabilities); income or expenditure.

Our review of the Council's WGA information is in progress at the date of this letter. We will complete our review in accordance with the Group Audit Instructions issued by the National Audit Office. This requires that we compare the information in your Data Collection Tool (DCT) submission with the audited financial statements, undertake testing of completeness and accuracy of WGA counter party transactions and balances, and provide an assurance statement to the National Audit Office.

USE OF RESOURCES (COUNCIL ONLY)

CONCLUSION

We issued our unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 12 October 2017.

SCOPE OF THE AUDIT OF USE OF RESOURCES

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources based on the following reporting criterion:

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

As part of reaching our overall conclusion we consider the following sub criteria in our work: informed decision making, sustainable resource deployment, and working with partners and other third parties.

OUR ASSESSMENT OF SIGNIFICANT RISKS

Our audit was scoped by our cumulative knowledge brought forward from previous audits, relevant findings from work undertaken in support of the opinion on financial statements, reports from the Council including internal audit, information disclosed or available to support the governance statement and annual report, and information available from the risk registers and supporting arrangements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and direction of the efforts of the audit team.

USE OF RESOURCES

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
<p>The updated Medium Term Financial Strategy, to 2021/22, forecasts that the Council will need to make £101m of savings over the next five years, driven by inflationary, demographic and service pressures alongside reductions in central government funding.</p> <p>In response to this, the Council has embarked upon a Transformation Programme to change the way that it delivers its services. This is still in its early stages but its success will underpin the Council's ability to maintain financial sustainability in the medium term.</p>	<p>We reviewed the reasonableness of the assumptions used in the Medium Term Financial Strategy and considered the reasonableness of the assumptions applied in the forecasts in respect of cost pressures and government grant reductions.</p> <p>We reviewed the progress being made in respect of the Transformation Programme, including how the programme is being managed in the context of the new arrangements associated with devolution.</p> <p>In 2016/17 there was a £510k (0.1%) overspend against the revenue budget and an underspend of £5.3m against the capital programme. General reserves have reduced to 2.8% of budgeted 2017/18 gross non-school expenditure which is below the 3% minimum recommended. It is anticipated this will be addressed during the 2018/19 business planning process.</p> <p>Positive progress has been made in the year to improve the business planning and savings monitoring processes with a more rigorous approach being applied and greater scrutiny. It continues to evolve and it is recognised that time is needed for the new ways of working to filter down through the teams and embed the new culture.</p> <p>The medium term financial position remains a significant challenge for the Council. This is recognised within the Council's risk register. The Business Plan has been based on reasonable assumptions using the latest information the Council has available and is updated regularly. Managing spend in demand led services is critical to delivery of the Business Plan as well as to transforming services.</p> <p>The new Combined Authority (CA) has taken on some of the Council's responsibilities, particularly in relation to transport. As a result additional funding has been made available for the region that will bring benefits to it. The Council is represented on the CA Board, but the Board has yet to publish its vision and detailed financial plans and therefore it is too early to assess the impact the CA has on the Council and its responsibilities and finances.</p>	<p>We had no issues to report by exception.</p>

EXERCISE OF STATUTORY POWERS

REPORT BY EXCEPTION

We received an objection from a local taxpayer regarding the lawfulness of certain transactions included in the financial statements.

OBJECTIONS RECEIVED FROM TAXPAYERS

We have received an objection from a local elector relating to matters concerning payments made to, and the governance exercised in respect of, contracts and procurement processes.

This work remains on going although we were satisfied that these matters did not have a material effect on the financial statements or on our value for money conclusion.

We will formally respond to the objectors upon completion of our work.

AUDIT CERTIFICATE

We are unable to issue the audit certificate to close the audit until we have completed our investigations and responded to objectors for the matters raised.

APPENDIX

REPORTS ISSUED

We issued the following reports since our previous annual audit letter.

REPORT	DATE
Audit plan - Council	3 March 2017
Audit plan - Pension Fund	13 April 2017
Audit completion report - Council	12 October 2017
Audit completion report - Pension Fund	12 October 2017
Annual audit letter	27 October 2017



FOR MORE INFORMATION:

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The matters raised in our report prepared in connection with the audit are those we believe should be brought to the attention of the organisation. They do not purport to be a complete record of all matters arising. No responsibility to any third party is accepted.

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