



CAMBRIDGESHIRE COUNTY COUNCIL AND CAMBRIDGESHIRE PENSION FUND

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2016



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 financial year ended 2015/16. 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 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 and our grant claims and returns certification work.

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

BDO LLP

4 November 2016

Audit conclusions

FINANCIAL STATEMENTS

We issued unqualified true and fair opinions on the Council and Pension Fund financial statements on 17 October 2016.

A number of material and non-trivial audit differences were identified by the audit and corrected by management.

We reported our detailed findings to the Audit and Accounts Committee on 20 September and 14 October 2016. We reported on uncorrected misstatements which were immaterial.

USE OF RESOURCES (COUNCIL ONLY)

We issued an unqualified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 17 October 2016.

EXERCISE OF STATUTORY POWERS

We have not exercised our statutory powers and have no matters to report.

GRANT CLAIMS AND RETURNS CERTIFICATION (COUNCIL ONLY)

We have prepared a reasonable assurance report in relation to the Local Transport Plan Major Projects Chesterton Busway scheme managed by the Council. We concluded that the return submitted to the sponsoring Department in respect of the above scheme was prepared, in all material respects, in accordance with the associated grant conditions subject to two matters which we reported to the grant paying body.

FINANCIAL STATEMENTS

OPINION

We issued unqualified true and fair opinions on the Council and pension fund financial statements on 17 October 2016.

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's and pension fund's 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 the pension fund and its environment, including the system 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 directing of the efforts of the audit team.

REVENUE RECOGNITION (COUNTY COUNCIL AND PENSION FUND)	RESPONSE	FINDINGS
<p>Auditing standards presume that there are risks of fraud in revenue recognition. These risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue.</p> <p>In particular, we considered there to be a significant risk in relation to the completeness and existence of fees and charges recorded in the Consolidated Income and Expenditure Statement (CIES) of the Council's financial statements.</p>	<p>Our review of revenue recognition in the Council's financial statements focused on testing the completeness and existence of an increased sample of fees and charges across all service areas within the CIES.</p> <p>For revenue recognised in the Pension Fund's financial statements, we performed tests of control over the reconciliation and verification process for employer returns. We performed sample testing and recalculations to verify the pensionable pay and contribution rates to employer records and returns. We recalculated member and employer contributions rates and compared employer rates to those mandated by the actuary.</p>	<p>No issues were identified from our testing of revenue from fees and charges recognised in the Council's financial statements.</p> <p>We identified a control deficiency in relation to the recognition of contributions in the Pension Fund's financial statements whereby contributions posted directly to the Pension Fund's IT systems from the employer payrolls are not currently reconciled or verified.</p>

FINANCIAL STATEMENTS

Continued

PENSION LIABILITY ASSUMPTIONS (COUNTY COUNCIL AND PENSION FUND)	RESPONSE	FINDINGS
<p>An actuarial estimate of the pension fund liability to pay future pensions 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 uses inappropriate assumptions to value the liability.</p>	<p>We agreed the disclosures included in the Council's financial statements to the information provided by the pension fund actuary.</p> <p>As the auditors of the Cambridgeshire Pension Fund, we reviewed the controls for providing accurate membership data to the actuary.</p> <p>We reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data using the PwC consulting actuary report for the review of the methodology of the actuary and reasonableness of the assumptions.</p>	<p>Our audit of the Pension Fund identified a difference due to the movement in fund asset values provided to the actuary by Cambridgeshire Pension Fund and the year-end values included in the Pension Fund's accounts. We calculated that the estimated value of the understatement of the Council's share of the pension fund liability arising as a result of this issue was £3.1 million. No adjustment was made to the Council's financial statements in respect of this issue and we were satisfied that this did not have a material impact on the financial statements.</p> <p>No issues were identified in our review of the assumptions used and our work on accounting estimates did not identify any evidence of bias.</p>

OPENING BALANCES - TRANSPORT INFRASTRUCTURE ASSETS (COUNTY COUNCIL)	RESPONSE	FINDINGS
<p>The predecessor auditor identified that the Council does not maintain a sufficiently detailed asset register to support the transport infrastructure assets balance recognised in the balance sheet. These assets had a net book value of £687m as at 31 March 2015. The nature of the assets meant that the Council was unable to construct an asset register to support the existing balance.</p> <p>Due to this issue identified in the prior year, there was a risk that the brought forward balances associated with this category of asset were materially misstated.</p>	<p>We considered the conclusions reached by the predecessor auditor to satisfy ourselves that the risk of material misstatement in the brought forward balances was reduced to an acceptably low level. This included engaging in appropriate technical consultation with our Technical Standards Group.</p> <p>We considered to what extent the Council's recognition and measurement of transport infrastructure assets was consistent with our understanding of the methodology employed by the wider local government sector.</p>	<p>We were satisfied that the balances brought forward in relation to infrastructure assets were materially correct.</p> <p>We obtained sufficient evidence that movements in the infrastructure assets balance during the year were materially correct.</p>

FINANCIAL STATEMENTS

Continued

PROPERTY, PLANT AND EQUIPMENT VALUATIONS (COUNTY COUNCIL)	RESPONSE	FINDINGS
<p>Property, plant and equipment were revalued during the year. The valuations were based on assumptions that are uncertain by nature. There is a risk of material misstatement if inappropriate or inaccurate assumptions are used in the calculation of fair values.</p> <p>Our review of the Council's draft financial statements presented for audit identified that the movement on the value of property due to revaluation was lower than expected in the context of national indices. Specifically, we identified revaluation losses where national indices indicated that revaluation increases would be expected.</p> <p>Given the uncertain nature of the assumptions used and unexpected valuation movements, we considered that the valuation of property, plant and equipment presented a significant risk of material misstatement.</p>	<p>We reviewed the significant assumptions used by the external valuers for accuracy and reasonableness.</p> <p>We confirmed that the basis of valuation for assets valued in year is appropriate based on their usage.</p> <p>We considered the independence, objectivity and competence of the external valuers engaged by management.</p>	<p>We were satisfied that the assumptions used by the valuers were reasonable and that the basis of the valuations were appropriate.</p> <p>Our review of the independence, objectivity and competence of the external valuers did not identify any issues.</p>
LENDER OPTION BORROWER OPTION ("LOBO") LOANS (COUNTY COUNCIL)	RESPONSE	FINDINGS
<p>A number of councils which hold LOBO loans received objections as to the lawfulness of the decision to take this form of borrowing. While no objection was received in relation to LOBO loans held by the Council, the National Audit Office gave guidance to auditors that, where a local authority has material LOBOs, the auditor should complete sufficient work around considerations relating to the lawfulness of the decision to enter into the LOBO agreements and the likelihood of a material liability arising from possible future restitution claims from banks.</p>	<p>We have obtained and reviewed the documentation to establish the conditions under which the LOBO borrowing was taken. We considered whether any factors existed which could give rise to a material liability at the balance sheet date should the decisions to enter into these loans be determined unlawful at a future date. We have taken appropriate legal and technical advice in performing this work.</p>	<p>Our review of the Council's available documentation did not lead us to have any significant concerns regarding the process the Council went through to enter into the arrangements and we concluded that the likelihood of the loans being deemed unlawful, and that a material restitution claim would follow, was remote. We were therefore satisfied that the treatment of these loans in the financial statements was appropriate and no further disclosures were required.</p>

FINANCIAL STATEMENTS

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CLASSIFICATION OF LEASES ASSOCIATED WITH INVESTMENT PROPERTIES (COUNTY COUNCIL)	RESPONSE	FINDINGS
<p>During 2015/16, the Council recognised one of its assets, Castle Court, as an investment property following the completion of capital works to convert it from offices to student accommodation.</p> <p>The property was been leased to a third party and, for accounting purposes, the agreement was treated as an operating lease in the draft financial statements provided for audit.</p>	<p>We reviewed the terms of the associated lease to determine whether or not it had been correctly classified in the Council's financial statements.</p>	<p>We concluded that the nature of the lease agreement was such that it should have been treated as a finance lease and not an investment property. Management amended the financial statements accordingly.</p> <p>De-recognition of the asset in the balance sheet resulted in a reduction in the value of investment properties by £19.957 million and increase of long term receivables by £21.300 million. Associated corrections in the CIES resulted in reduction of other operating expenditure by £12.002 million and financing and investment income by £10.659 million. The net impact of these adjustments was a decrease in the deficit on the provision of services of £1.343 million.</p>

FINANCIAL STATEMENTS

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FAIR VALUE OF INVESTMENTS (CAMBRIDGE AND COUNTIES BANK) (PENSION FUND)	RESPONSE	FINDINGS
<p>The investment in the Cambridge and Counties Bank is unquoted and is valued by an external valuer appointed by the fund.</p> <p>The valuation of the investment may be subject to a significant level of assumption and estimation.</p>	<p>We engaged in discussions at an early stage with officers about their proposed approach to valuation for the current period and ongoing. An external valuer was engaged to undertake the valuation and reported to the Fund in May 2016.</p> <p>We engaged specialist valuations experts within BDO to analyse and assess the external valuation on which the value in the financial statements was based. We reviewed the assumptions and methodology used in the valuation, and the accuracy and appropriateness of these in producing a final valuation.</p> <p>We considered the value held in the financial statements against the results and conclusions of these reviews.</p>	<p>We did not identify any material misstatement of the value used in the accounts as a result of inappropriate assumptions or estimates.</p>

FINANCIAL STATEMENTS

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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 £14.935 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 1.5 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 £22.800 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 identified in the Council's accounts in excess of £299,000 and in the Pension Fund's accounts in excess of £450,000.

Audit differences - Council

Corrected misstatements

Our audit identified a number of material differences which were corrected by management:

- £17.422 million of growth deal funding applied in 2015/16 which was not recognised in the CIES.
- £29.078m Revenue Expenditure Capitalised Under Statute (REFCUS) which was incorrectly netted off income in the CIES. This had no impact on the reported deficit.
- £71.642 million REFCUS in the prior year which was also incorrectly netted off in the prior year's CIES. As this is material a prior period adjustment was required and a narrative note included to explain the restatement of the prior year comparatives.
- incorrect treatment of the finance lease associated with Castle Court, which was recognised as an investment property in the balance sheet as previously set out on page 6.
- £42.496 million error in the prior year cash flow statement relating to the movement in the pension fund liability. This had no impact on the cash balance brought forward into the current year.

Management also made a number of additional non-material, non-trivial adjustments the correction of which reduced the reported deficit for the year by £31.059 million.

Uncorrected misstatements

Our audit identified two audit differences not corrected in the final financial statements that impact on the reported deficit:

- £468,000 being the projected difference due to an overstatement of accrued expenditure.
- £1.178 million being the projected difference due to an understatement of accrued expenditure.

Correcting for these misstatements would result in the Council reporting a £710,000 higher deficit for the year.

FINANCIAL STATEMENTS

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There were also two uncorrected differences which, if corrected, would have no impact on the reported deficit:

- £3.1 million understatement of the Council's share of the Cambridgeshire Pension Fund liability due to a difference in the movement in fund asset values provided to the actuary by the Pension Fund and the year-end values included in the Pension Fund's accounts.
- £2.139 million arising from incorrect recognition of debtors related to capital grants as receipts in advance..

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

Audit differences - Pension Fund

Our audit found the following audit differences not corrected in the final financial statements that impact on the reported net assets:

- £632,000 relating to double counted contributions in 2016, and understated in previous years, due to a catch-up exercise to correct mistakes in previous years and correct the cumulative position under the 10 year deficit contribution agreement with Magistrates Court Committee.
- £208,000 extrapolated differences between PEN18 totals and amounts included within contributions in accounts.
- £1.000 million relating to the difference in value of Cambridge and Counties Bank due to subordinated loans deducted twice.
- £956,000 associated with unreconciled differences between contributions posted directly to the Pension Fund's IT system and included in employer returns.
- £3.411 million being the reclassification of benefits paid to match the nature of actual transactions associated within each subjective account.

- £703,000 being the difference between the unit price used by the custodian and that used by the investment manager
- £698,000 being the net reversal of incorrect journal entries made during the preparation of the financial statements.

Correcting for these misstatements would reduce the decrease in the fund for the year by £747,000 and would decrease net assets by £115,000.

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

Other matters we report on

Annual governance statement

We were satisfied that the Annual Governance Statement was not misleading or inconsistent with other information we were aware of from our audit.

Narrative reporting

Local authorities are required to include a narrative report in the Statement of Accounts to offer interested parties an effective guide to the most significant matters reported in the accounts. The narrative report should be fair, balanced and understandable for the users of the financial statements.

We were satisfied that the information given in the narrative report for the financial year for which the financial statements are prepared was consistent with the financial statements.

Internal controls

We identified that the main accounting system used by both the Council and the Pension Fund does not prevent officers from authorising their own journals. This matter was raised by the previous external auditor as a significant deficiency in internal control.

FINANCIAL STATEMENTS

Continued

Our testing of journals processed by the Council identified that some manual journals were found to have been posted by a budget holder to their own cost centres. This is contrary to the normal procedure of financial advisors posting journals and results in a lack of effective segregation of duties. We recommended that budget holders are restricted from posting manual journals to the cost centres for which they are responsible.

Our testing of journals processed by the Pension Fund identified the following:

- A control was implemented during the year to address the issue raised by the previous external auditor involving review of the nature of all journals over £50,000. We identified the following issues with this:
 - This control was only performed as a year-end exercise, meaning it would be difficult to recognise an unusual journal.
 - An irregular journal is defined as those above £50,000 that have not been identified as a 'type'. Not all journals over £50,000 were labelled as a 'type', but none were considered irregular during the year-end review.

A number of other areas for improvement in the internal control environment were identified in respect of both the Council and Pension Fund which we have discussed with management.

Whole of Government Accounts (Council Only)

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.

We have completed 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.

Our review of the Council's draft DCT submission found a number of inaccuracies which were subsequently amended by management. We concluded that the information in the amended DCT was consistent with the Statement of Accounts and that the counter party transactions and balances were consistent with the accounting records.

We issued our assurance statement to the National Audit Office on 28 October 2016.

USE OF RESOURCES (COUNCIL ONLY)

CONCLUSION

We issued an unqualified conclusion on the arrangements for securing economy, efficiency and effectiveness in its use of resources on 17 October 2016.

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 information obtained from your previous auditor, 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 directing of the efforts of the audit team.

SUSTAINABLE FINANCES	RESPONSE	FINDINGS
<p>The Council, like other authorities, is facing a significant reduction in grants. The 2016/17 budget includes expected funding of £542m excluding grants retained by schools which equates to a 12% reduction compared to 2015/16. The Council needs to deliver £51m of savings in 2016/17 alone and £123m over the next five years. This represents a substantial challenge for the Council and will require robust project management and significant transformation of services and the Council as a whole. Inevitably, difficult decisions will need to be made in order to deliver the new priority outcomes based model.</p> <p>There is a significant risk that without appropriate arrangements in place, the Council will fail to deliver the required level of savings.</p>	<p>We reviewed the assumptions contained within the medium term financial plan to assess their reasonableness, reviewed in detail some of the savings plans, both delivered and proposed, and conducted interviews with a number of officers to challenge the proposed plans. We also reviewed the process for designing and implementing plans for new operating models to achieve transformational savings.</p> <p>We reviewed the budget setting process and the in-year financial monitoring to ensure there are robust and accurate processes in place.</p>	<p>The assumptions contained within the medium term financial plan appeared to be comprehensive and reasonable.</p> <p>Overall, in a very uncertain financial future the Council's Budget Plan sets out a path for the sustainable use of resources available.</p> <p>We concluded that the Council understands the financial challenges that it faces and has adequate arrangements in place to manage the financial position in the medium term.</p>

EXERCISE OF STATUTORY POWERS

REPORT BY EXCEPTION

We have not exercised our statutory powers and have no matters to report.

Use of statutory powers

We received an enquiry relating to administration of a traffic calming scheme by the Council. We considered the content of the enquiry and concluded that it did not constitute an objection under section 14 of the Accounts and Audit Regulations 2015 and that it was outside the scope of our responsibilities. The information contained in the enquiry did not lead us to have any serious concerns about the way the Council is managed or led.

Consequently, we have not exercised our statutory powers.

Audit certificate

We were unable to issue the Audit Certificate until the Whole of Government Accounts return had been completed. This was completed on 28 October 2016 and we issued the audit certificate to close the audit for the year ended 31 March 2016 on the same day.

GRANT CLAIMS AND CERTIFICATION (COUNCIL ONLY)

CERTIFICATION WORK

Our review of grant claims and returns for 2015/16 is complete.

Claims and returns

A number of grant claims and returns that were previously included within the scope of the audit have since been removed, but Departments may still seek external assurance over the accuracy of the claim or return.

These assurance reviews are undertaken outside of our appointment by Public Sector Audit Appointments Ltd and are covered by tripartite agreements between the Council, sponsoring Department and the auditor.

The Council has requested that we undertake a 'reasonable assurance' review, based on the instructions and guidance provided by the Departments, for the following return for the Local Transport Plan Major Projects - Chesterton Busway scheme for 2015/16.

We concluded that the return submitted to the sponsoring Department in respect of the above scheme was prepared, in all material respects, in accordance with the associated grant conditions subject to the following matters:

- No detailed business case or bid document was prepared by the Council in relation to the project as it was initially planned and developed by a third party
- The return submitted to the Department reflected all expenditure incurred on the project, rather than just that incurred during 2014/15.

These matters were reported in our reasonable assurance report to the sponsoring government department.

APPENDIX

Reports issued

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

REPORT	DATE
Audit Plan - Council	6 May 2016
Audit Plan - Pension Fund	27 May 2016
Audit report to the Audit and Accounts Committee - Council	20 September & 14 October 2016
Audit report to the Audit and Accounts Committee - Pension Fund	20 September & 14 October 2016
Annual Audit Letter	4 November 2016

Fees

We reported our original fee proposals in our Audit Plan.

AUDIT AREA	PLANNED FEES	FINAL FEES
Code audit - Council ⁽¹⁾	94,061	94,061
Code audit - Pension Fund	22,410	22,410
Fee for audit services	116,471	116,471
Audit related services:		
- Skills Funding Agency	3,750	3,794
- Local Transport Plan Major Projects	4,000	4,131
Fee for audit related services	7,750	7,925
Non audit related services:		
- None	-	-
Total fees	124,221	124,396

(1) The final audit fees for the audit have not yet been agreed and will be reported separately. The fee shown here is the Public Sector Audit Appointments Ltd scale fee for the audit.

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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