

Hertfordshire County Council and Pension Fund

Annual Audit Letter for the year ended 31 March 2017

October 2017

Ernst & Young LLP

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

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The “Terms of Appointment (updated 23 February 2017)” issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure - If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

A hand holding a pen writing on a document in an office setting with a calculator and a laptop.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Hertfordshire County Council following completion of our audit procedures for the year ended 31 March 2017.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's and Pension Fund's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2017 and of its expenditure and income for the year then ended.
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception: ▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts (WGA) purposes. We reported a mapping difference between the Council's financial statements and the WGA return of £18.9 million in relation to New Homes Bonus and the Education Services Grant. This is not an error, just a difference in the reporting on the template. We agree with the Council's approach. No further issues were identified.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 11 th September 2017.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 11 th September 2017.

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

Neil Harris

Associate Partner
For and on behalf of Ernst & Young LLP

Purpose



Purpose

The Purpose of this Letter

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

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report to the 11th September Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.



Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued on 1st March 2017 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2016/17 financial statements, including the pension fund; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

Responsibilities of the Council

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

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Financial Statement Audit

Financial Statement Audit

Key Issues

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

We audited the Council and Pension Fund's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 11 September 2017.

Our detailed findings were reported to the 11 September 2017 Audit Committee.

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

Significant Risk	Conclusion
<p>Management override of controls</p> <p>A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p>	<p>Our testing of journal entries did not identify adjustments which were outside of the normal course of business. All journals tested have an appropriate business rationale.</p> <p>The most significant accounting estimates in the financial statements relate to the net pension liability and property valuations. We challenged the assumptions in these areas and found no indication of management bias in these estimates.</p> <p>During the course of our audit we did not identify any significant unusual transactions. This includes our detailed review of the adjustments through the Movement in Reserves Statement.</p> <p>We have not identified any material weaknesses in controls or evidence of material management override. We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.</p>

Revenue and expenditure recognition

Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.

We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end.

For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.

Our testing of journal entries did not identify adjustments which were outside of the normal course of business. All journals tested have an appropriate business rationale.

We reviewed and tested material revenue and expenditure streams including:

- accounting estimates to identify any issues or evidence of management bias;
- cut-off testing around period end to assess whether the recognition or deferral of this income and expenditure was appropriate;
- capital expenditure on property, plant and equipment to confirm it met the relevant requirements to be capitalised.

Overall our audit work did not identify any material misstatements with respect to revenue and expenditure recognition. No issues or unusual transactions were identified which would indicate that there had been any misreporting of the Council's financial position.

Our testing of capital expenditure did not identify any expenditure which had been inappropriately capitalised.

Other Risks

Property Asset Valuation

Valuation of property assets is a significant accounting estimate that has a material impact on the financial statements.

Conclusion

Our testing assessed and placed reliance on property valuation specialists commissioned by the Council. We assessed and used an independent valuer's market report to review and challenge the assumptions and judgements used by the Council's external valuer.

We tested the accounting entries made for revaluations, including assessing assumptions, asset use and valuation methods. There were no significant amendments in this area.

Pension Scheme Liability

The Council is required to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body.

The Council's current pension fund deficit is a highly material and a sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the administering body.

Our audit procedures assessed the conclusions drawn on the work of the actuary by the Consulting Actuary to the PSAA, PwC; and also assessed the reasonableness assumptions made by the Actuary (including estimations and judgements).

We reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS 19.

There were no significant matters to report.

Group Accounts

The Council set up two companies in September 2013:

- Hertfordshire Catering Ltd (wholly-owned subsidiary).
- Herts for Learning (20% is owned by the Council).

The Council continues to assess these interests as quantitatively and qualitatively material to the group and therefore the Council will continue to consolidate the companies into the Council's group accounts as required by the Code of Practice on Local Authority Accounting in the United Kingdom (Code of Practice).

There is a risk that the group financial statements do not meet the requirements as defined by the Code.

We reviewed the Council's assessment of all potential group entities against accounting standards IFRS10 and 11.

We reviewed and tested that the Council adopted and correctly applied accounting policies that comply with the requirements of the Code.

We reviewed the correctness of the consolidations entries from the companies' accounts to the Council's group accounts. We also tested that all disclosures in relation to group accounts were appropriate.

There were no significant matters to report.

Children's Services PFI Schemes

The Council entered into a PFI scheme in June 2007 through a private sector operator for the design, finance and maintenance of several children's services.

Our audit procedures included the construction of a parallel accounting model to assess whether the County's accounting model for the Children's Services PFI scheme was materially accurate. The parallel model confirmed no material differences in accounting for this project.

The outstanding liabilities to be paid to the contractors for capital expenditure as at 31 March 2016 were £16,185million.

Our procedures did identify a difference in the output of the two models of £1.885m. This difference is likely to have arisen from the more detailed County accounting model, which correctly recognised the liability for each individual asset at the point it was completed, compared with the parallel model which assumes a single completion date.

It is a number of years since this PFI scheme was reviewed in detail by audit and therefore we believe additional work needs to be carried out to ensure the values and accounting disclosures associated with this PFI scheme remain accurate and in line with the original contract arrangements.

There were no further matters to report.

CIPFA Code Changes

Amendments have been made to the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the Code) this year changing the way the financial statements are presented.

We reviewed the expenditure and funding analysis, CIES and new notes to ensure disclosures were in line with the code.

The new reporting requirements impact the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS), and include the introduction of the new 'Expenditure and Funding Analysis' note as a result of the 'Telling the Story' review of the presentation of local authority financial statements.

We reviewed the analysis of how these figures are derived, how the ledger system has been remapped to reflect the Council's organisational structure and how overheads are apportioned across the service areas reported.

We agreed the restated 2015/16 comparative figures back to the Council's segmental analysis and supporting working papers.

The Code no longer requires statements or notes to be prepared in accordance with SeRCOP. Instead the Code requires that the service analysis is based on the organisational structure under which the authority operates. We expect this to show the Council's segmental analysis.

A technical review was conducted which identified amendments in disclosure and positioning of the Expenditure and Funding Analysis note within the financial statements. All of these amendments were agreed with management.

This change in the Code will require a new structure for the primary statements, new notes and a full retrospective restatement of impacted primary statements. The restatement of the 2015/16 comparatives will require audit review, which could potentially incur additional costs, depending on the complexity and manner in which the changes are made.

Our application of materiality

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

Item	Thresholds applied
Planning materiality	<p><u>Hertfordshire County Council's Statements</u></p> <p>We determined planning materiality to be £19.9 million (2015/16: £17.1 million), which is 1% of gross expenditure reported in the accounts of £1,990 million.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p> <p><u>Pension Fund's Statements</u></p> <p>We determined planning materiality to be £42.2 million (2015/16: £35.8 million), which is 1% of net assets reported in the accounts of £4,220 million.</p> <p>We consider net assets to be one of the principal considerations for stakeholders in assessing the financial performance of the Pension Fund.</p>
Reporting threshold	<p><u>Hertfordshire County Council's Statements</u></p> <p>We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.99 million (2015/16: £0.85 million)</p> <p><u>Pension Fund's Statements</u></p> <p>We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £2.10 million (2015/16: £1.80 million)</p>

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

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

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

A close-up, shallow depth-of-field photograph of a stack of coins. The coins are stacked vertically, with some showing their edges and others showing their faces. The lighting is warm, highlighting the metallic texture and the ridges on the edges. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Value for Money".

Value for Money

Value for Money

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

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

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



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

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

We therefore issued an unqualified value for money conclusion on 11 September 2017.

Significant Risk	Conclusion
<p>Continued Reduction in Funding</p> <p>The impact of continuing reductions in funding from central government is particularly challenging for the Council. With restrictions on annual Council Tax increases, the Council's medium-term financial strategy (MTFS) identifies the need to identify and deliver significant savings from 2017/18 and future years.</p>	<p>There is a robust budget setting process in place with challenge built into the process from officers and members. The 2016/17 budget was met with an underspend.</p> <p>Assumptions built into the budget are based on best information available and the Council has articulated within its budget the risks associated with upcoming changes to government policy and the economic climate. There is evidence throughout the MTFS that the Council has considered the impact of various scenarios and the impact these will have on budget planning.</p> <p>The Council has worked with partners to deliver efficiencies and savings and continues to do so with some significant arrangements in place. Overall we recognise there continues to be challenges faced by the Council as they seek to identify and implement savings.</p>
<p>Sustainability and Transformation Plans (STPs)</p> <p>STPs give local NHS organisations and councils the opportunity to work together to improve the way health and social care is designed and delivered.</p> <p>The Hertfordshire and west Essex publication 'A Healthier Future' brings together the challenges and opportunities that face NHS and care services in Hertfordshire and west Essex as they work together to improve health and wellbeing within the funds available.</p>	<p>The Council has engaged proactively in the STP process and is working closely with partners from high level planning to a more detailed delivery model. Working groups are in place to ensure the delivery of the plan. The Council acknowledges that this is a complex challenging area that is requiring a lot of resource to contribute to the financial sustainability of the Council in the context of the health economy.</p> <p>Overall, the Council has been proactive in its engagement with the STP, working with partners, in considering and reflecting the service pressure and spending risks from health and social care in the MTFS. We recognise there remain a number of challenges, particularly how the Council's assumptions align in with those of the STP, now and in the future.</p>

In Hertfordshire and west Essex £3.1bn a year is spent on health and social care. The position is increasingly stretched with a potential funding gap of £550 million a year by 2021 unless services can act together.

While the Council has a history of being well managed and aware of issues impacting the County area as a whole, we consider there is a significant risk in relation to the Council's ability to deal with the challenging health and social care environment and deliver the savings required.



Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts (WGA) purposes.

We reported a mapping difference between the Council's financial statements and the WGA return of £18.9 million in relation to New Homes Bonus and the Education Services Grant. This is not an error, just a difference in the reporting on the template. We agree with the Council's approach. No further issues were identified.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2016/17 financial statements from member of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 11 September 2017. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

Our audit did not identify any controls issues to bring to the attention of the Audit Committee.

A close-up photograph of a person's face as they look through a pair of black binoculars. The person's eyes are focused on the lenses. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Focused on your future".

Focused on your
future

Focused on your future

Area	Issue	Impact
<p><i>Earlier deadline for production and audit of the financial statements from 2017/18</i></p>	<p>The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From next year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.</p>	<p>These changes provide challenges for both the preparers and the auditors of the financial statements.</p> <p>To prepare for this change the Council has taken some steps in 2016/17. For example it has started to critically review and amend the closedown process to achieve earlier draft accounts production.</p> <p>As auditors, nationally we have:</p> <ul style="list-style-type: none"> • Issued a thought piece on early closedown • As part of the strategic Alliance with CIPFA jointly presented accounts closedown workshops across England, Scotland and Wales • Presented at CIPFA early closedown events and on the subject at the Local Government Accounting Conferences in July 2017 • Invited clients to a Faster Close workshop <p>We have agreed with the Council to engage early, following the completion of the 2016/17 audit, to facilitate early substantive testing for 2017/18 and also to consider steps the Council can take, for example:</p> <ul style="list-style-type: none"> • Streamlining the Statement of Accounts removing all non-material disclosure notes • Bringing forward the commissioning and production of key externally provided information such as IAS 19 pension information, asset valuations • Re-ordering tasks from year-end to monthly/quarterly timing, reducing year-end pressure • Establishing and agreeing working materiality amounts with the auditors

Appendix A

Audit Fees



Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our 11 September 2017 Annual Results Report.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Hertfordshire County Council Total Audit Fee - Code work	142,067	142,067	142,067	142,067
Hertfordshire Pension Fund Total Audit Fee - Code Work	33,491	33,491*	27,991	27,991
Non-audit work Teacher's Pension**	TBC	13,000	N/A	13,000

*£5,500 in relation to IAS 19 procedures. In previous years this work has been something of an anomaly in that we have not charged for it; however PSAA has agreed scale fee variations to cover the necessary work. This is consistent with the approach taken by other firms which act as external auditors for the Local Government Pension Schemes. The scale fee variation is subject to PSAA approval.

**2016/17 fee relates to the work completed on the 2015/16 Teachers Pension return as the work is completed in the financial year following preparation of the return (2015/16 relates to 2014/15 completed return).

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ED None

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