

Annual Audit Letter

Cheshire East Council

Year ending 31 March 2019





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1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Cheshire East Council (the Council) for the year ended 31 March 2019. 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 responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 31 July 2019 included our opinion that the financial statements:</p> <ul style="list-style-type: none">• give a true and fair view of the Council's financial position as at 31 March 2019 and of its expenditure and income for the year then ended; and• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 31 July 2019 included our opinion that:</p> <ul style="list-style-type: none">• The other information in the Statement of Accounts is consistent with the audited financial statements.
Value for Money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.</p>
Reporting to the Whole of Government Accounts group auditor	<p>In line with group audit instructions issued by the NAO, we will report to the group auditor in line with the requirements applicable to the Council's Whole of Government Accounts return. The deadline for our report to the NAO is 13 September 2019.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

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 2019 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 (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 auditor's report, issued to the Council on 31 July 2019, stated that, in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2019 and of its financial performance for the year then ended.

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 & Governance 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 2019:

		Council	Group
Financial statement materiality	Our financial statement materiality is based on 1.5% of the gross expenditure at the Surplus/Deficit on Provision of Services level	£10,800,000	£11,000,000
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality	£324,000	£330,000
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Officer Remuneration bandings - Related Party Transactions	£5,000 £50,000	n/a n/a

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2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant 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 & Governance 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.

Identified significant risk	Our response	Our findings and conclusions
<p>Management override of controls 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 override 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"> Accounting estimates impacting on 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>There were no significant matters arising from our work on the management override of controls</p>
<p>Valuation of Property, Plant & Equipment The CIPFA Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. The valuation of Property, Plant & Equipment involves the use of a management expert (the valuer), and incorporates assumptions and estimates which impact materially on the reported value. There are risks relating to the valuation process. In addition, as a result of the rolling programme of revaluations, there is a risk that individual assets which have not been revalued for up to four years are not valued at their materially correct fair value.</p>	<p>In relation to the assets which had been revalued during 2018/19 we assessed the Council's valuer's qualifications, objectivity and independence to carry out such valuations, and reviewed the valuation methodology used, including testing the underlying data and assumptions. We compared the valuation output with market intelligence provided by Gerald Eve, consulting valuers engaged by the National Audit Office, to obtain assurance that the valuations are in line with market expectations.</p> <p>We reviewed the approach that the Council adopted to address the risk that assets not subject to valuation in 2018/19 are materially misstated and we considered the robustness of that approach in light of the valuation information reported by the Council's valuers.</p> <p>In addition, we considered the movement in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values have moved materially over that time.</p>	<p>We did not identify any significant matters from our testing, and we concluded that the valuation of the Council's Property, Plant & Equipment was materially fairly stated.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks (continued)

Identified significant risk	Our response	Our findings and conclusions
<p>Valuation of Defined Benefit Pension Liability</p> <p>The net pension liability represents a material element of the Council's balance sheet. The Council is an admitted body of Cheshire Pension Fund, which had its last triennial valuation completed as at 31 March 2016. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.</p> <p>There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates and mortality rates. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>There is a risk that the assumptions and methodology used in valuing the Council's pension obligation are not reasonable or appropriate to the Council's circumstances. This could have a material impact to the net pension liability in 2018/19.</p>	<p>As part of our work we reviewed the controls that the Council has in place over the information sent to the Scheme Actuary, including the Council's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of the scheme Actuary, Hymans Robertson.</p> <p>We reviewed the appropriateness of the methodology applied in the valuation of the liability by Hymans Robertson, and the key assumptions included within the valuation, comparing them to expected ranges, utilising the information provided by PwC, consulting actuary engaged by the National Audit Office. We reviewed the methodology applied. We considered the Council's response to the key risks that emerged through the audit relating to legal cases that impact on the Local Government Pension Scheme. We also considered the Council's accounting in 2018/19 for the deficit contribution payment it made in 2017/18. We also considered the Council's accounting of the pension liability for its wholly-owned subsidiary companies.</p>	<p>Our work on the valuation of the LGPS Pension Liability has not identified any significant issues and we have obtained assurance that the valuations are not materially misstated.</p>

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

Our approach to the Value for Money conclusion

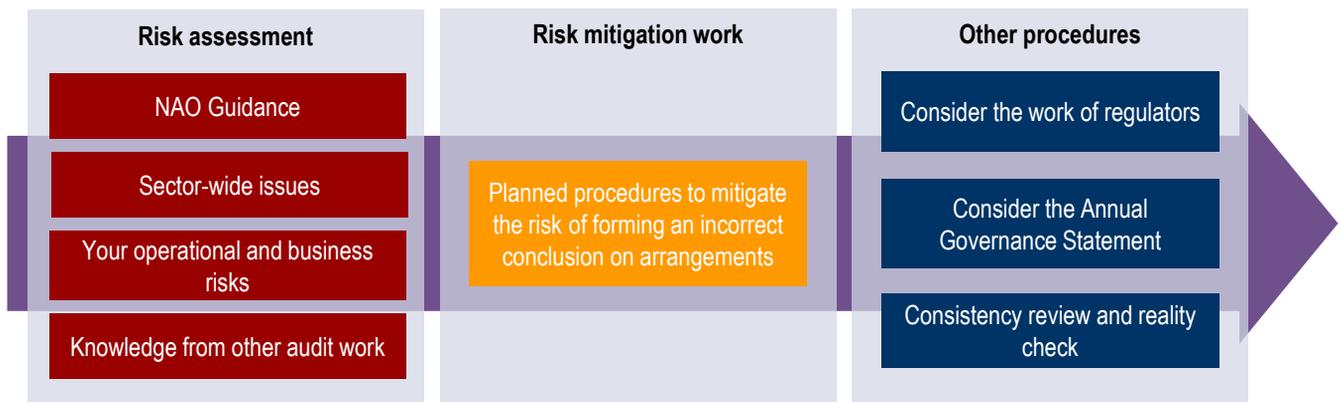
We are required to consider whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion 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
- Working with partners and other third parties

Our auditor's report, issued to the Council on 31 July 2019, stated that that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2019.

A summary of the work we have undertaken is provided below:



Significant risks to our Value for Money conclusion

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate. In our Audit Strategy Memorandum, we reported that we had identified two significant Value for Money risks:

- Financial sustainability; and
- Good governance to support informed decision making.

The work we carried out in relation to the significant risks is outlined overleaf.



3. VALUE FOR MONEY CONCLUSION

Risk	Work undertaken and findings	Conclusion
<p>Financial Sustainability</p> <p>The Council's medium term financial strategy for the period 2016/17 to 2019/20 sets out the financial challenges it faces. The mid year reporting for 2018/19 indicated that the Council was projecting to overspend this year's budget by £5.3m, placing further pressure on service delivery and increasing the use of reserves to support the revenue expenditure.</p> <p>The continuing challenges the Council faces are not new and are not unique to Cheshire East Council. However, the challenges do present a significant audit risk in respect of considering the arrangements that the Council has in place to deliver financially sustainability over the medium term.</p>	<p>Work undertaken</p> <p>We reviewed the arrangements the Council had in place throughout 2018/19 for ensuring financial resilience. Specifically we reviewed whether the medium term financial plan took into consideration factors such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors. We also reviewed the arrangements in place to monitor progress delivering the budget and related savings plans.</p> <p>Findings</p> <p>Based on the work carried out we established that:</p> <ul style="list-style-type: none"> • The Council had a robust budget setting process in place for 2018/19 and 2019/20. • The monitoring through the year was timely and detailed and enables the Council to manage its financial position through the year accurately. • There were overspends in some demand-led areas in 2018/19, but overall the Council maintained strong control of its budgets. • Overall the budget overspend was not significant, and the use of earmarked reserves in 2018/19 was not significantly more than budgeted. • The level of overall earmarked reserves was adequate, and provided sufficient flexibility for the Council to deliver financial sustainability in the medium term 	<p>We concluded that for 2018/19 the Council had made proper arrangements to deliver financial sustainability in the medium term.</p>



3. VALUE FOR MONEY CONCLUSION

Risk	Work undertaken and findings	Conclusion
<p>Good governance to support informed decision making</p> <p>In 2017/18, the Council’s previous auditors qualified their Value for Money conclusion on the basis of inadequate arrangements for good governance to support informed decision making. We have taken the previous auditor’s conclusions into account in considering the significant Value for Money risks in 2018/19, and we have concluded that this area is a significant risk for our work.</p> <p>During 2018/19 the Council continued to operate with temporary senior management arrangements for key posts including the Chief Executive, Section 151 Officer and Monitoring Officer.</p> <p>To demonstrate that the arrangements were adequate for 2018/19, the Council will need to demonstrate that its governance arrangements, particularly relating to strategic and financial decision making matters were operating efficiently and effectively.</p>	<p>Work undertaken</p> <p>We reviewed the Council’s governance arrangements particularly focusing on the decision making process for strategic and financial decisions.</p> <p>In addition we focused our work on the work the Council has undertaken to addressing the historical governance issues, focusing on the arrangements relating to whistleblowing, procurement, land transactions, and the Council’s plans to move forward from the temporary senior management arrangements to permanent arrangements.</p> <p>Findings</p> <p>The findings from each of the areas of our review were:</p> <ul style="list-style-type: none"> • The Council’s whistleblowing policy has been produced using guidance documents from ‘Public Concern at Work’, and provides a clear outline on how seriously the Council takes whistleblowing. The policy provides guidance on how to raise concerns under the policy, where to raise concerns and with whom. The policy has been refreshed regularly and is publicised. The Council have actively involved Public Concern at Work in evaluating the policy and suggesting improvements. • The Council’s arrangements for procurement are set out in its Contract Management Framework. The approach is based on an assessment of the size and business criticality of the contract being let. Categorising contracts as Platinum, Gold, Silver and Bronze allows the Council to put in place arrangements that are appropriate to the contract. Contracts assessed as high value with a high level of Business Criticality are segmented as Platinum contracts, and these contracts receive the highest level of oversight and scrutiny, involving senior management, procurement, legal and finance officers and Council members in the decision making process. 	<p>We concluded that for 2018/19 the Council had made proper arrangements for governance to support informed decision making.</p>
[continued overleaf]		



3. VALUE FOR MONEY CONCLUSION

Risk	Work undertaken and findings	Conclusion
<p>Good governance to support informed decision making</p> <p>In 2017/18, the Council’s previous auditors qualified their Value for Money conclusion on the basis of inadequate arrangements for good governance to support informed decision making. We have taken the previous auditor’s conclusions into account in considering the significant Value for Money risks in 2018/19, and we have concluded that this area is a significant risk for our work.</p> <p>During 2018/19 the Council continued to operate with temporary senior management arrangements for key posts including the Chief Executive, Section 151 Officer and Monitoring Officer.</p> <p>To demonstrate that the arrangements were adequate for 2018/19, the Council will need to demonstrate that its governance arrangements, particularly relating to strategic and financial decision making matters were operating efficiently and effectively.</p>	<p>Findings (continued)</p> <ul style="list-style-type: none"> • The Council has invested significant resource into establishing a detailed Contract Management Framework and monitoring compliance with this Framework. Our review of contract letting through the year provided assurance that the Council is following its own processes, and an internal audit report in May 2018 concluded that the procurement governance arrangements were satisfactory. • The Council has clearly focused significant corporate and departmental attention into strengthening the governance arrangements over land transactions following the internal audit reports into historical transactions. The Council has responded positively to the internal audit action plan, issued in August 2018, and has reported progress internally, identifying the progress made against each of the recommendations. The Council has established more robust reporting and governance arrangements including an Assets Board, a Capital Programme Board, and record keeping that focuses on the need for comprehensive audit trails of decisions taken and information considered. Further actions are being completed and the Council’s progress is reported through to Corporate Leadership Team. • The Council has operated through 2018/19 with a significant number of ‘acting’ and ‘temporary’ amongst senior staff, operating under a corporate structure based on three Directorates (People, Place, Corporate). The Council acknowledged that needed to be updated. We note the revised structure has now been established implemented in 2019/20. 	<p>We conclude that for 2018/19 the Council has made proper arrangements for governance to support informed decision making.</p>

[continued overleaf]



3. VALUE FOR MONEY CONCLUSION

Risk	Work undertaken and findings	Conclusion
<p>Good governance to support informed decision making</p> <p>In 2017/18, the Council’s previous auditors qualified their Value for Money conclusion on the basis of inadequate arrangements for good governance to support informed decision making. We have taken the previous auditor’s conclusions into account in considering the significant Value for Money risks in 2018/19, and we have concluded that this area is a significant risk for our work.</p> <p>During 2018/19 the Council continued to operate with temporary senior management arrangements for key posts including the Chief Executive, Section 151 Officer and Monitoring Officer.</p> <p>To demonstrate that the arrangements were adequate for 2018/19, the Council will need to demonstrate that its governance arrangements, particularly relating to strategic and financial decision making matters were operating efficiently and effectively.</p>	<p>Findings (continued)</p> <ul style="list-style-type: none"> In considering the arrangements for decision making in place in the year we have focused on whether the decision making has been appropriate, and whether the appointments of the ‘acting’ and ‘temporary’ senior management indicates appropriate governance over staff planning. Our review considered the operational arrangements in place to deliver devolved decision making with robust governance in place. Our review has assured us that the Council has been progressing with its implementation of a revised structure through the year, and has subsequently implemented this structure in 2019/20. Furthermore we are assured that there is evidence of robust decision making, taking into account relevant information and applying the Council’s constitution and delegation arrangements. 	<p>We conclude that for 2018/19 the Council has made proper arrangements for governance to support informed decision making.</p>



4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of WGA group audit reporting requirements	To be completed and reported by 13 September 2019
Other information published alongside the audited financial statements	Consistent

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 on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers during our audit.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the WGA Assurance Statement in respect of its consolidation data, and to carry out certain tests on the data. The deadline for completion of this work is 13 September 2019 and we will submit our report to NAO by this deadline.

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 other information in the Statement of Accounts was consistent with the audited financial statements.

5. OUR FEES

Fees for work as the Council's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the Audit & Governance Committee in January 2019.

Having completed our work for the 2018/19 financial year, we can confirm that our final fees are as follows:

Area of work	2018/19 final fee	2018/19 planned fee
Delivery of audit work under the NAO Code of Audit Practice	£119,034	£119,034

Fees for other work

We have not undertaken any other engagements for the Council or its subsidiary companies in 2018/19.

6. FORWARD LOOK

Financial resilience

Fair Funding Review

The Government announced in August that it would produce a one-year spending review setting out the department allocations for 2020/21 with the three-year spending review being delayed until later in 2020. Regardless of the timing and period covered by the spending reviews, the Council will need to continue to respond positively the management of general reserves to ensure reserves remain at a level to deliver financial resilience and to enable the Council to deliver sustainable services.

Local Authority Financial Resilience Index

CIPFA is moving forward with its financial resilience index, which it believes will be a barometer on which local authorities will be judged. We would expect the Council to have at least considered the index once it is formally released.

Commercialisation

The National Audit Office will be publishing a report on Commercialisation during 2019. Depending on the Council's appetite for commercialisation, we would expect the Council to consider the outcome of the report and ensure any lessons learnt are incorporated into business practice.

Further, the UK Debt Management Office's Annual Report, published in July 2019, reported that, as at 31 March 2019, the Public Works Loan Board's loan book was £78.3 billion with 1,308 new loans totalling £9.1 billion advanced during the year. The challenge for Councils with regards to its borrowing, and its commercialisation agenda is to be able to clearly demonstrate:

- the value for money in the use of Public Works Loan Board funds to acquire commercial property; and
- the prudence of its arrangements for loan repayment through applying the updated statutory guidance on Minimum Revenue Provision in 2019/20, 2020/21 and beyond.

Financial Reporting

Lease accounting

The implementation of IFRS 16 Leases in the Code is delayed until 1 April 2020. The Council will need a project plan to ensure the data analysis and evaluation of accounting entries is completed in good time to ensure any changes in both business practice and financial reporting are captured.

UK Local Government Annual Accounts

The CIPFA/LASAAC Local Authority Code Board specifies the financial reporting requirements for UK local government.

A consultation is underway to inform the direction and strategy for local government annual accounts. We will be submitting our response and suggest that Councils also voice their opinion by responding to the consultation.

Audit developments

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. We have responded to the National Audit Office's consultation on the content of the Code (<https://www.nao.org.uk/code-audit-practice/about-code>)

A new Code will be laid in Parliament in time for it to come in to force no later than 1 April 2020.

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