Annual Audit Letter

Cheshire East Council

Year ending 31 March 2020

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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 2020. 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	Our auditor's report issued on 27 November 2020 included our opinion that the financial statements: • give a true and fair view of the Council's financial position as at 31 March 2020 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 2019/20
Other information published alongside the audited financial statements	Our auditor's report included our opinion that: • the other information in the Statement of Accounts is consistent with the audited financial statements.
Value for money conclusion	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 2020.
Reporting to the group auditor	In line with group audit instructions, issued by the NAO on 4th November, we reported to the group auditor in line with the requirements applicable to the Council's WGA return.
Statutory reporting	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. The report also confirmed that we did not exercise any other special powers of the auditor under sections 28, 29 or 31 of the 2014 Act.

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 2020 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, stated that in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2020 and of its financial performance for the year then ended. Our report included an emphasis of matters paragraph. This drew attention to the financial statement disclosure explaining that COVID-19 had contributed to 'material valuation uncertainty' in the valuation of the Council's land and buildings and the Council's share of Cheshire Pension Fund's property assets included in the net Pension Liability.

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 2020:

		Council	Group
Financial statement materiality	Based on 1.5% of the gross expenditure at the Surplus/Deficit on Provision of Services level	£13,800,000	£14,000,000
Trivial threshold	Based on 3% of financial statement materiality	£414,000	£420,000
Specific materiality	- Officer Remuneration bandings	£5,000	n/a
	- Related Party Transactions	£50,000	n/a

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
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. Because of 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	We addressed this risk through performing audit work over: • 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.	There were no significant matters arising from our work on the management override of controls
Property, plant and equipment valuation 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.	We assessed the 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. We reviewed the Council's approach to ensuring that assets not subject to valuation in 2019/20 are materially misstated and we considered the approach in light of the valuation information reported by the valuers. 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. We also considered the potential impact of the Covid-19 pandemic on the Council's asset valuations and the adequacy of the disclosures in the financial statements, specifically those relating to the material uncertainty disclosed by your valuer to their valuations.	We concluded that the valuation of the Council's Property, Plant & Equipment was materially fairly stated. However, the Council disclosed in Note 37 that the valuation of the property assets were subject to 'material valuation uncertainty' as a result of COVID-19, and we included an 'emphasis of matter' in our auditor's report. A 'material valuation uncertainty' declaration does not mean that the valuation cannot be relied upon, but that, less certainty can be attached to the valuation.

Our response to significant risks (continued)

Identified significant risk	Our response	Our findings and conclusions
Valuation of Defined Benefit Pension Liability 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 2019. 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. 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. There is a risk 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 2019/20.	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. 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. In addition our work focused on two issues that emerged through 2020. In July 2019, MHCLG consulted on the proposed remedy for the 'McCloud' case, an estimate of which was included in the Council's liability in 2018/19 and 2019/20. The proposed remedy indicates that the actuarial estimate of the liability for 2018/19 and 2019/20 was likely to be overstating the pension fund liability but not materially. A second emerging issue this year is the 'Goodwin' case which also relates to groups of pension fund members suffering discrimination. Although the impact of 'Goodwin' is still being clarified the Council's actuary have provided evidence to support their assessment of the impact on the Council's liability. They conclude that the impact is not likely to be material. In both issues, we engaged with the Council's actuary and reviewed the evidence provided by the pension fund and the Council's actuary in order to conclude on the material accuracy of the liability.	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. Our other work on the Pension disclosures identified some non-material disclosure adjustments. The Council amended the financial statements for all the adjustments. However, the Council disclosed in Note 37 that the valuation of the property assets held by Cheshire Pension Fund were subject to 'material valuation uncertainty' as a result of COVID-19, and we included an 'emphasis of matter' in our auditor's report.

Internal control recommendations

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

The matters we report are limited to those deficiencies and other control recommendations that we have identified during our normal audit procedures and that we consider to be of sufficient importance to merit being reported.

We identified one internal control deficiency. This was not significant in nature and related to management review of IT access. Management has agreed to strengthen arrangements to address the control recommendation during 2020/21. We are content with management's response.

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; and
- working with partners and other third parties.

Significant audit risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to our conclusion exists. Risk, in the context of our 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 one significant audit risk. The work we carried out in relation to the significant risk is outlined overleaf.

Overall Conclusion

Our auditor's report, stated that that, is 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 2020.

Significant audit risks (continued)

Risk	Work undertaken	Conclusion
Financial Sustainability The Council's medium term financial strategy for the period 2016/17 to 2019/20 set out the financial challenges it faces. The mid year reporting for 2019/20 indicated that the Council was projecting to overspend this year's budget by £7.5m, placing further pressure on service delivery and increasing the use of reserves to support the revenue expenditure. The continuing challenges the Council faces are not new and are not unique to Cheshire East Council. The challenges do, however, 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.	**Work undertaken** We reviewed the arrangements the Council had in place throughout 2019/20 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. In addition, although the financial impact of Covid-19 on the Council was not significant in 2019/20 we have considered the Council's approach to understanding and reporting the impact around the end of the financial year. Based on the work carried out we established that: • The Council has a robust budget setting process in place for 2019/20 and 2020/21. • The monitoring through the year is timely and detailed and enables the Council to manage its financial position through the year accurately. • There are overspends in some areas in 2019/20, but overall the Council has maintained good control of its budgets. • Overall the budget overspend is not significant, and the use of earmarked reserves in 2019/20 is not significantly more than budgeted. • The level of overall earmarked reserves provides some flexibility for the Council to deliver financial sustainability in the medium term.	We conclude that for 2019/20 the Council has made proper arrangements to deliver financial sustainability in the medium term. However, the size and scale of the financial challenges in the medium term have been significantly impacted by Covid-19 and this places significant extra pressure on the Council's arrangements in 2020/21 and future years.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	**No matters to report**
Completion of group audit reporting requirements	**Consistent**
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.

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. We completed this work and submitted this information to the NAO on 15 February 2021.

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 is 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 December 2019.

Having completed our work for the 2019/20 financial year, we can confirm that our final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice	119,034	119,034
Fee variations*:		
Recurrent scope changes due to increased regulatory expectations:		
• Additional testing on Property, Plant & Equipment		4,954
• Additional testing on Defined Benefit Pensions Schemes		2,998
In year scope changes due to Covid-19 and pension legal cases including, but not limited to: • impact of 'Material Valuation Uncertainty' on the Council's land and buildings and its share of Pension Fund property assets; • updating audit risk assessments, including the value for money conclusion; • additional considerations of estimation uncertainty in going concern; • changes impacting pension liabilities through the McCloud and Goodwin legal cases.		5,032
Other matters: • additional PPE work (including extensive liaison with the Council's new valuer - to secure the required audit evidence)		3.246
Total audit fee	**119,034**	**135,264**

*Fee variations subject to confirmation from PSAA

Fees for other work

We confirm that we have not undertaken any non-audit services for the Council in the year.

6. FORWARD LOOK

Changes to the Code of Audit Practice

The Code of Audit Practice (the Audit Code), issued by the Comptroller and Auditor General, prescribes the way we carry out our responsibilities as your auditors. On 1st April 2020 a new Code came in to force and will apply to our work from 2020/21 onwards.

The new Audit Code continues to apply the requirements of International Standards on Auditing (ISAs) to our audit of the financial statements. While there are changes to the ISAs that are effective from 2020/21 the Audit Code has not introduced any changes to the scope of our audit of the financial statements. We will continue to give our opinion on the financial statements in our independent auditor's report.

There are however significant changes to the work on value for money arrangements, and the way we report the outcomes of our work to you.

The auditor's work on value for money arrangements

From 2020/21 we are still required to satisfy ourselves that you have made proper arrangements for securing the economy, efficiency and effectiveness in your use of resources, however unlike under the 2015 Audit Code, we will no longer report in the form of a conclusion on arrangements. Instead, where our work identifies significant weaknesses in arrangements, we are required to report those weaknesses to you, along with the actions that need to be taken to address those weaknesses.

Our work on value for money arrangements will focus on three criteria, specified in the revised Audit Code:

- Financial sustainability: how the body plans and managers its resources to ensure it can continue to deliver its services;
- Governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

Under the new Audit Code we will be expected to report and make recommendations as soon as we identify a significant weakness in arrangements, as opposed to reporting our conclusion on arrangements at the end of the audit cycle as has previously been the case.

Reporting the results of the auditor's work

We currently issue you with an Annual Audit Letter which provides a summary of our work across all aspects of our audit. From 2020/21 the Annual Audit Letter will be replaced by the Auditor's Annual Report. This will continue to provide a summary of our work over the year of audit but will also include a detailed commentary on your arrangements in place to achieve economy, efficiency and effectiveness. This commentary replaces the conclusion on arrangements that was previously provided and will include details of any significant weakness identified and reported to you, follow up of any previous recommendations made, and the our view as to whether recommendations have been implemented satisfactorily.

The new Audit Code will result in additional officer time and auditor time and therefore audit fees.

6. FORWARD LOOK: AUDIT CHANGES 2020/21

Redmond Review

In September 2020, Sir Tony Redmond published the findings of his independent review into the oversight of local audit and the transparency of local authority financial reporting. The report makes several recommendations that, if implemented, could affect both the financial statements that local authorities are required to prepare and the work that we as auditors are required to do.

The report and recommendations are wide-ranging, and includes:

- the creation of the Office of Local Audit and Regulation (OLAR), to manage, oversee and regulate local audit;
- reviewing reporting deadlines;
- reviewing governance arrangements in local authorities, including the membership of the Standards and Audit Committee; and
- increasing transparency and reducing the complexity of local authority financial statements.

The full report is available here: https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review

The recommendations and findings have been considered by the Ministry of Housing, Communities and Local Government and their response was published in December 2020. The response accepted some recommendations but did not accept others.

We look forward to working with all stakeholders to implement changes to ensure the development and sustainability of local audit.

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