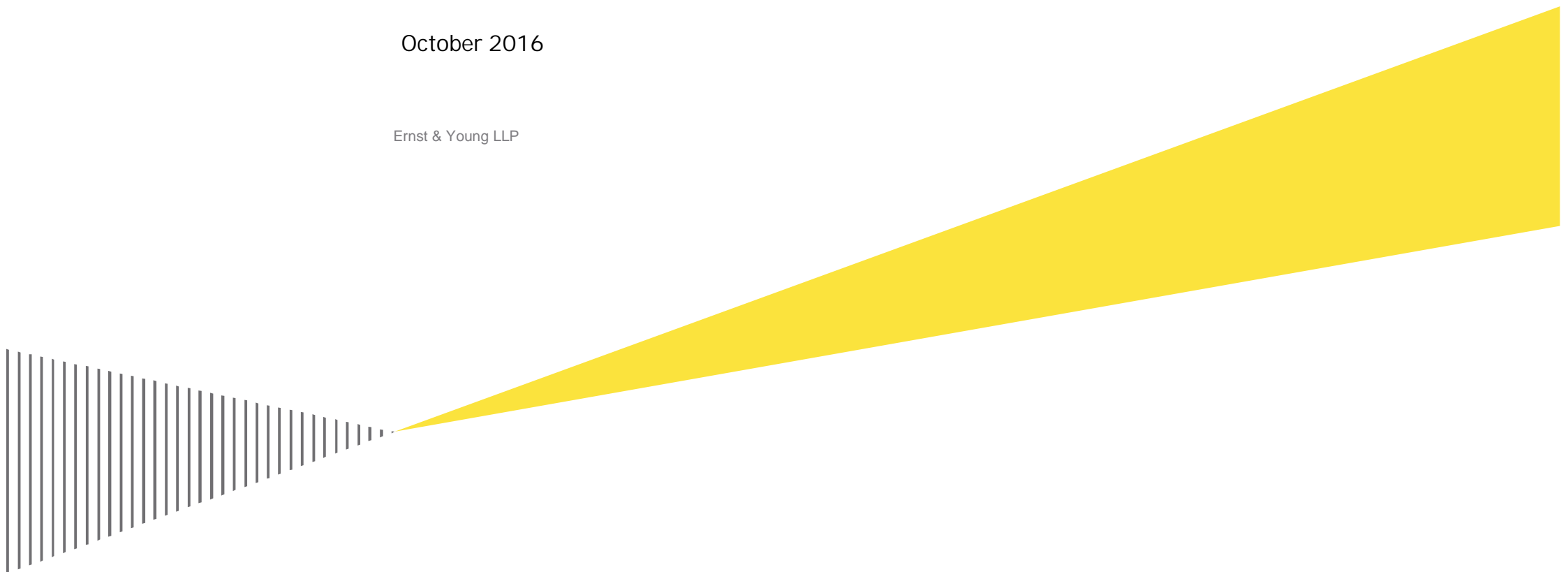


Essex County Council

Annual Audit Letter for the year ended 31 March 2016

October 2016

Ernst & Young LLP



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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued “Statement of responsibilities of auditors and audited bodies 2015-16”. 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 from 1 April 2015’ 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 with white nail polish is writing on a document with a blue pen. In the background, there is a calculator, a laptop, and a white mug. A yellow rectangular box is overlaid on the left side of the image.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Essex County Council and Essex Pension Fund following completion of our audit procedures for the year ended 31 March 2016.

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 2016 and of the 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 had put in place proper arrangements to secure value for money in the use of your resources with the exception of your arrangements for sustainable resource deployment, where you had not yet identified budget proposals to fully bridge the budget gap for 2017/18 and later years. We have commented on this further in the key messages section.

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 had no matters to report.

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 presented at the Audit Committee on 21 September 2016.
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.	<p>We have not as yet issued our audit completion certificate.</p> <p>We are required to give an opinion on the consistency of the financial statements of the pension fund included in the Pension Fund Annual Report of Essex Pension Fund. The Local Government Pension Scheme Regulations require authorities to publish the Pension Fund Annual Report by 1 December 2016. As the Authority has not yet finalised the Annual Report we have not yet been able to conclude on the consistency with these financial statements and we have not issued our report on those financial statements. We have audited the draft Annual Report and are not anticipating any issues.</p> <p>Until we have completed these procedures we are unable to certify that we have completed the audit of the accounts in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice issued by the National Audit Office.</p>

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

Andrew Clewer

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 2015/16 Audit Results Report to the 21 September 2016 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 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 21 March 2016 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 2015/16 financial statements; 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 their use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statements are 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 their 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 their use of resources.

The background is a blurred office scene. In the foreground, there are several clear glass tumblers filled with water on a wooden desk. Behind them, a laptop screen displays a financial chart. To the left, a pen and some papers are visible. The overall lighting is bright and natural, suggesting a window nearby.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how they have used public money and how they can demonstrate their 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 21 September 2016.

Our detailed findings were reported to the 21 September 2016 Audit Committee.

The key risks and 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>We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation. No issues were identified.</p> <p>Our review of accounting estimates has found that estimates are reasonable, and there was no indication of bias in the calculation of the estimates.</p> <p>We have not identified any evidence of management override.</p> <p>We have not identified any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the normal course of business.</p> <p>We did not identify any errors in respect of the incorrect capitalisation of revenue spend.</p>

Significant Risk	Conclusion
<p>Revenue and expenditure recognition</p> <p>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.</p> <p>We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end.</p> <p>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.</p>	<p>Our testing has not revealed any misstatements with respect to revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the financial position.</p> <p>Our testing did not identify any expenditure which had been inappropriately capitalised.</p> <p>Our cut off procedures did not identify any issues.</p>
<p>Pension valuations and disclosures</p> <p>The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body.</p> <p>The Council's current pension fund deficit is a highly material and sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet.</p> <p>The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the administering body.</p> <p>Accounting for this scheme involves significant estimation and judgement.</p> <p>Due to the nature, volume and size of the transactions we consider this to be a significant risk. However, the Council does not have a history of any issues in accounting for their pension scheme.</p>	<p>We reviewed the actuarial reports and the appropriateness of the IAS 19 valuation methodology applied and did not identify any issues.</p>

Significant Risk	Conclusion
<p>Accounting for property, plant and equipment (PPE)</p> <p>PPE represent a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges.</p> <p>Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet.</p> <p>As the Council's asset base is significant, and the outputs from the valuer are subject to estimation, there is a risk PPE may be under/overstated or the associated accounting entries incorrectly posted.</p>	<p>Our audit testing identified a number of audit differences relating to PPE which management have corrected. This included the prior period adjustment discussed below.</p>
<p>Waste treatment plant Private Finance Initiative (PFI)</p> <p>The Council entered into a material PFI contract in May 2012 for the design, construction and operation of a waste treatment plant in Basildon, Essex. The physical construction work was completed during 2014/15, and the plant is now in its 'commissioning phase'. Once the commissioning has been completed, an Acceptance Test Certificate will be issued, after which the plant will become fully operational and will come onto the Council's balance sheet, together with the associated PFI liability.</p> <p>There is a risk that the plant may not reach the required performance levels to enable the costs to be capitalised.</p>	<p>We agreed with the Council's view that the Waste treatment plant PFI should remain off balance sheet for 2015/16.</p> <p>We reviewed relevant correspondence provided to us and have understood the basis of the matters which have been referred to the independent expert.</p> <p>The Council have disclosed a contingent liability in respect of this PFI scheme in 2015/16. The basis for the Council's judgement is clear. Given this is subject to a high degree of uncertainty, we acknowledge that a contingent liability disclosure is appropriate.</p> <p>We are satisfied that the revised contingency disclosure in respect of the Waste PFI meets the requirements of IAS 37.</p>

Other Risks	Conclusion
<p>The Better Care Fund (BCF)</p> <p>The Better Care Fund (BCF) is a major policy initiative between local authorities, clinical commissioning groups (CCGs) and NHS providers with a primary aim of driving closer integration and improving outcomes for patients, service users and carers. The BCF has been set up as pooled budget between local government and NHS partners using powers available under pre-existing legislation from 1 April 2015. The partners use the pooled fund to jointly commission or deliver health and social care services at a local level.</p> <p>The Essex Health and Wellbeing Board (HWBB) BCF plan for 2015/16 totalled £102.3m. The Essex BCF received full approval from NHS England in February 2015.</p> <p>This is the first time the BCF has been accounted for in the Council's financial statements.</p>	<p>We reviewed and evaluated the Council's assessment of whether the BCF meets the requirements for a joint arrangement under the Code and International Financial Reporting Standard (IFRS) 11 and reviewed the BCF disclosures and accounting entries back to supporting documentation, ensuring that the Council has accurately accounted for their portion of the BCF in the 2015-16 financial statements.</p> <p>Our testing did not identify any issues.</p>

Other Key Findings	Conclusion
<p>Prior Period Adjustment</p> <p>The Council de-recognised the Property, Plant and Equipment assets related to a number of community and foundation schools in 2014/15, following their conversion to academy status. However, it subsequently became apparent that some of the Property, Plant and Equipment assets de-recognised in 2014/15 had not been transferred to these Academy Schools.</p>	<p>The value of Property, Plant and Equipment de-recognised in error amounted to £15,051k. The Council initially corrected this error in the 2015/16 accounts, however it was concluded that the Council should correct the error as a 'Prior Period Adjustment' and therefore this has been adjusted for retrospectively by amending the comparative amounts for the prior period. The 2015/16 balance sheet remains unchanged and there was no impact on usable reserves.</p>



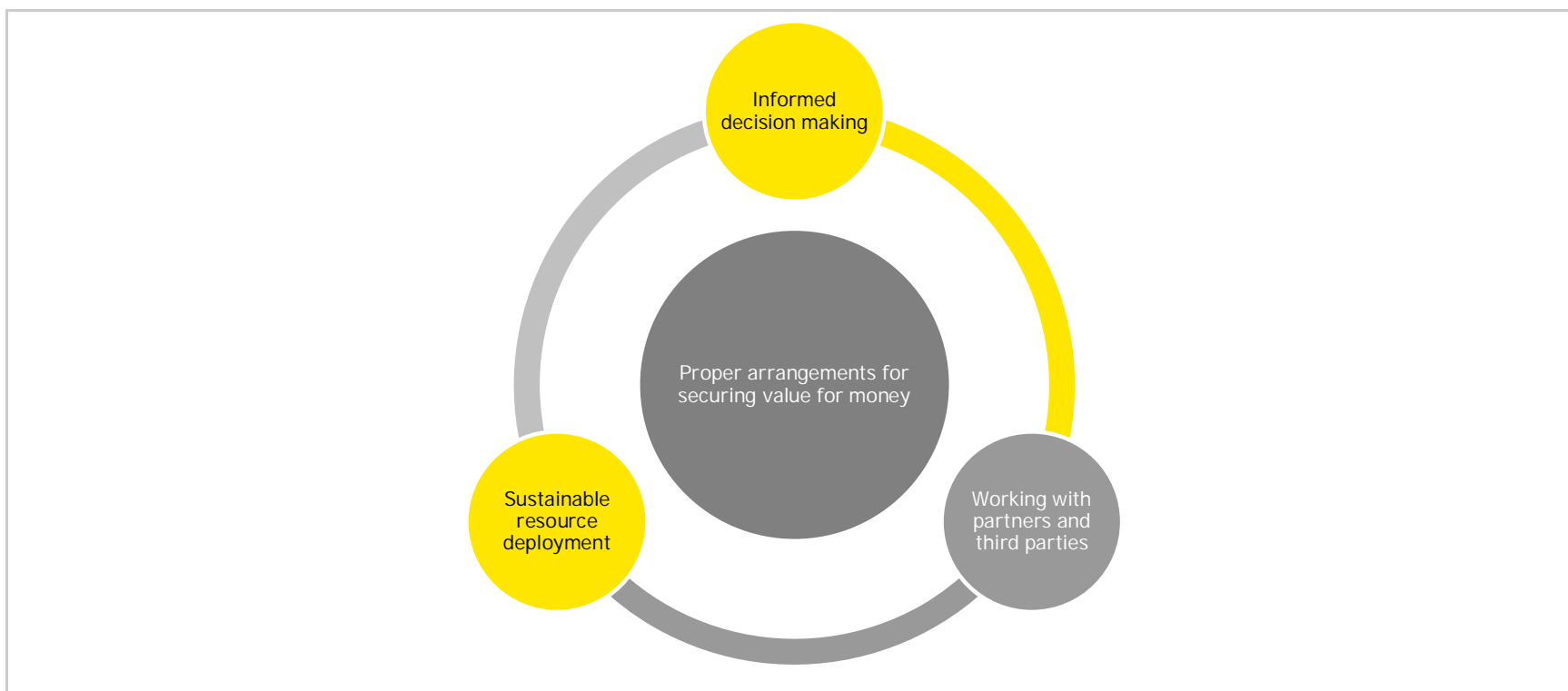
Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on their 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 issued an except for value for money conclusion on 21 September 2016.

We identified two risks to focus our work. The key findings are set out below.

Key Findings

Sustainable resource deployment: Achievement of savings needed over the medium term

To date the Council has responded well to the financial pressure resulting from the continuing economic downturn. However, the Council continues to face significant financial challenges over the next three to four years, with a forecasted underlying budget gap of £172m by 2018-19. Given the scale of the savings needed, there is a risk that savings planned to bridge this gap are not robust and/or achievable.

We considered the:

- ▶ adequacy of the Council's budget monitoring process, comparing budget to outturn.
- ▶ robustness of any assumptions used in medium term planning.
- ▶ the Council's approach to prioritising resources whilst maintaining services.
- ▶ savings/income plans in place, and assessing the likelihood of whether these plans can provide the Council with the required savings/efficiencies over the medium term.

In considering the Authority's arrangements for securing financial resilience, and for challenging how it secures economy, efficiency and effectiveness we identified the following:

- ▶ The Authority have disclosed in the 'Revenue Spending plan for 2016/17' section of the Narrative Report that whilst a balanced budget was set for 2016/17, the Authority forecasts a budget gap of approximately £273m over the period to 2018/19 (£101 million in 2017/18, increasing to £172 million by 2018/19).
- ▶ The Authority, in line with previous years, is undertaking a review of budget proposals (savings and income generating opportunities) to bridge the gap. At this stage, the 2017/18 year savings are substantially identified, although not exacted, but the following years remain challenging.
- ▶ Unless the budget gap forecast in the Medium Term Financial Strategy is closed the Authority would have almost completely exhausted its usable revenue reserves by the end of 2018/19.

In our view, despite the commencement of a significant reorganisation project to identify the required savings, the Authority has not yet been able to make sufficient progress in identifying the savings required to demonstrate its ability to secure a stable financial position over the medium term.

We therefore concluded that you have put in place proper arrangements to secure value for money in your use of resources, except for the matter noted above.

Key Findings

Waste Treatment Plant – Basildon

The Council is party to a high value contract regarding the proposed waste treatment plant in Basildon. Construction costs in respect of this plant as at 31 March 2015 were approximately £107 million. The Council is currently awaiting the completion of the 'commissioning phase' and the receipt of the Acceptance Test Certificate, after which the plant will become fully operational. This however was yet to be finalised at the time of our audit opinion and there is a risk that the plant may not receive the necessary certificate to allow it to become fully operational. Given the significant costs to date, this presented a VFM risk should the plant not become fully operational.

Our work in response included:

- ▶ review of the PFI business case, including the outline procurement process and value for money assessments; and
- ▶ monitoring developments throughout the year.

Our work indicated that ECC does have good arrangements for governance and oversight over its significant contracts and it is clear that the Council have sought to achieve VFM as part of their procurement as well as contract management processes.

However, ECC are now exposed to financial and legal risks resulting from this PFI contract. For a complex organisation like ECC, this is not unusual. With a reducing funding position over the medium term and an increased focus on different ways of working in response, robust management of these risks becomes more important.

ECC needs to continue to strengthen its management and monitoring arrangements of significant contract and procurement projects to ensure it has a comprehensive understanding of all financial, legal and compliance risks it is exposed to from major projects.



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 purposes. We had no significant issues to report.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statements, to 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 2015/16 financial statements from members 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 21 September 2016. 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

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

A close-up, shallow depth-of-field photograph of a person's hands holding binoculars. The person's face is blurred in the background, focusing attention on the binoculars and the text overlay. A bright yellow rectangular box is positioned 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
Faster close	<p>From the 2017/18 financial year, the deadline for preparing the financial statements will move to 31 May from 30 June. In addition, the deadline for completing the statutory audit will move to 31 July from 30 September.</p>	<p>The faster closedown timetable requires the Council to adjust its timetable for preparing the accounts and the timing of committee meetings.</p> <p>It requires upfront planning to identify areas of the accounts that can be prepared earlier, before the 31 March, and there will be a need to establish robust basis for estimations across a wider number of entries in the financial statements.</p> <p>For the 2016/17 audit, we will work with officers to bring our work forward to support the transition ahead of the new deadlines in 2017/18.</p>
Appointment of auditors	<p>The current audit contracts expire on the completion of the 2017/18 audit. The expiry of contracts also marks the end of the current mandatory regime for auditor appointments.</p> <p>After this, the Council can exercise choice about whether it decides to opt in to the authorised national scheme, or whether to make other arrangements to appoint its own auditors.</p> <p>In July 2016, the Secretary of State for Communities and Local Government specified Public Sector Audit Appointments limited (PSAA) as an appointing person under regulation 3 of the Local Audit (Appointing Person) Regulations 2015.</p> <p>PSAA will be able to appoint an auditor to relevant authorities that choose to opt into its national collective scheme.</p>	<p>Appointment of auditors for the 2018/19 financial year is required by 31 December 2017.</p> <p>The Council has already made significant progress on considering whether they intend to opt into the appointed person scheme to appoint your auditors from 2018/19 or if the Council should make their own arrangements following the legislative requirements.</p>

Area	Issue	Impact
EU referendum	<p>Following the majority vote to end the UK's membership of the European Union (EU) in the EU Referendum held on 23 June 2016 there is a heightened level of volatility in the financial markets and increased macroeconomic uncertainty in the UK. All three major rating agencies (S&P, Fitch and Moody's) took action on the UK Sovereign credit rating and, following the rating action on the UK Government. For entities in the public sector, there is likely to be an impact on investment property valuations if confidence in the wider UK property market falls; and the valuation of defined benefit pension obligations may also be affected. It is too early to estimate the quantum of any impact of these issues, but there is likely to be significant ongoing uncertainty for a number of months while the UK renegotiates its relationships with the EU and other nations.</p>	<p>Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of the referendum and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions. We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will engage with you on the concerns and questions you may have, provide our insight at key points along the path, and provide any papers and analysis of the impact of the referendum on the Government and Public Sector market.</p>
Highways Network Asset	<p>The Code of Practice on Transport Infrastructure Assets (TIA Code) was first published in 2010 and updated in 2013. The key aim of this document was to improve the asset management of TIA. During 2016, this guidance has been renamed and updated, with the Highways Network Asset (HNA) Code, Guidance Notes and Accounting Guidance being published. Local Government has historically used depreciated historic cost (DHC) as the valuation approach for infrastructure assets. The introduction of the HNA Code will see this valuation basis change to depreciated replacement cost with effect from 1 April 2016. The change will be applied prospectively from that date, so Highways Authorities are not required to disclose comparative information.</p> <p>This is a fundamental change in approach which will require new accounting and estimation approaches as well as amendments to existing systems, or implementation of new systems.</p>	<p>The impact on the Council's Balance Sheet will be highly significant; with the recognition of a single highways network asset of approximately £21 billion. The impact on the audit will also be significant, as auditors will need to obtain sufficient assurance over the material accuracy of this asset.</p> <p>We will work closely with the Council at both the local level, regarding system implementation, valuation procedures and accounting, and at the wider level through the continuation of our HNA Client Workshops.</p>

Appendix A

Audit Fees



Appendix A Audit Fees

Our audit fee for 2015/16 is higher than the scale fee set by the PSAA and reported in our 21 September 2016 Annual Results Report.

Description	Final Fee 2015/16	Planned Fee 2015/16	Scale Fee 2015/16	Final Fee 2014/15
Total Audit Fee – Code work	£163,981	£163,981	£163,981	£218,641
Additional Audit Fee – Note 1	£15,000	N/A	N/A	£0
Non-audit work – Essex Teachers' Pension claim	£13,250	£13,250	N/A	£13,250
Total	£192,231	£177,231	£163,981	£231,891

All fees exclude VAT.

Note 1 – Our actual fee is different from the scale fee set by the PSAA at this point in time, subject to satisfactory clearance and agreement of the scale fee variation by PSAA. The proposed additional scale fee variation is £15,000, and relates to additional work performed on the Waste PFI and prior period adjustment discussed in the report above.

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ED None

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