

Annual Audit Letter

Gateshead Council



For the year ended 31 March 2017



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Executive summary

Purpose of this report

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Gateshead Council ('the Council') for the year ended 31 March 2017. 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 work | Summary |
|-------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Financial statements opinion | On 31 July 2017 we issued our opinion that the financial statements gave a true and fair view of the Council's financial position as at 31 March 2017 and of its financial performance for the year then ended. |
| Opinions on other matters | On 31 July 2017 we issued our opinion that the Narrative Report published with the financial statements, was consistent with those financial statements. |
| Value for Money conclusion | On 31 July 2017 we issued our conclusion that the Council had proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. |
| Whole of Government Accounts | In line with instructions issued by the NAO, on 29 September 2017 we issued our assurance certificate which reported that the Council's consolidation pack was consistent with the audited financial statements. |
| Matters that we report by exception | We did not identify any matters to report in relation to whether the Annual Governance Statement was in line with our understanding of the Council and the requirements of the Delivering Good Governance in Local Government Framework 2016. We received one objection to the Council's 2016/17 financial statements from a local elector on 6 July 2017. Whilst we have concluded that there were no matters from this objection that prevented us from issuing our opinion on the Council's financial statements of value for money conclusion, at this stage our work on the objection is ongoing. |

Given our work on the objection to the Council's financial statements is currently ongoing, we have not been yet able to certify the closure of the 2016/17 audit.

Audit of the financial statements

Financial statements opinion

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 2017 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 for the UK and Ireland (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 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 Accounts 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 2017:

| | |
|---------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Financial statement materiality | £8.133 million |
| Specific materiality | We have applied a lower level of materiality to the following items of account: <ul style="list-style-type: none">• Officer's remuneration;• Member's allowances; and• Termination payments. |
| Trivial threshold | £325,000 |

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 and Standards 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.

| Significant risk | How we addressed the risk | Audit conclusion |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
| <p>Management override of control</p> <p>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 overrides 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>Our testing strategy included:</p> <ul style="list-style-type: none"> • reviewing material accounting estimates, which may have been subject to management bias, included in the financial statements; • consideration and review of unusual or significant transactions outside the normal course of business; and • testing of journals recorded in the general ledger and other adjustments made in preparation of the financial statements. | <p>Our work provided the assurance we sought and did not highlight any material issues to bring to your attention.</p> |
| <p>Revenue Recognition</p> <p>There is a risk of fraud in the financial reporting relating to revenue recognition due to the potential to inappropriately record revenue in the wrong period. Due to there being a risk of fraud in revenue recognition we consider it to be a significant risk.</p> | <p>We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> • cash receipts from March to May 2017 to ensure they had been recognised in the right year; • testing adjustment journals; and • obtaining counterparty confirmation for major grant income. | <p>Our work provided the assurance we sought and did not highlight any material issues to bring to your attention.</p> |
| <p>Pensions Estimates (IAS19)</p> <p>The financial statements contain material pension entries in respect of the retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and</p> | <p>We discussed with key contacts significant changes to the pension estimates prior to the preparation of the financial statements. In addition to our standard programme of work in this area, we:</p> | <p>Our work provided the assurance we sought and did not highlight any material issues to bring to your attention.</p> |

| Significant risk | How we addressed the risk | Audit conclusion |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.</p> | <ul style="list-style-type: none"> evaluated the management controls you have in place to assess the reasonableness of the figures provided by the Actuary; and considered the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned annually by the National Audit Office. | |
| <p>Property, Plant and Equipment (PPE)</p> <p>Valuations of these assets, in particular of land and buildings, require work from an expert valuer. Valuations of buildings must reflect both the condition of the building but also the valuation basis for that class of building as required by the CIPFA 'Code'.</p> | <p>We examined the professional qualifications of the Council's valuer and challenged and substantiated the assumptions and the appropriateness of the date of the valuation used by your valuer in completing the valuations. In addition, we:</p> <ul style="list-style-type: none"> ensured that valuations and impairments had been completed on the correct basis for each item and that movements were in line with expectation; and assessed whether the report produced by the valuer was correctly reflected in the accounts. | <p>Our work provided the assurance we sought and did not highlight any material issues to bring to your attention. However, our work identified two non-material issues in relation to the way that the Council revalued particular assets.</p> |
| <p>Introduction of new Payroll system (iTrent)</p> <p>The Council introduced a new Payroll system in April 2016. This introduction brings with it the potential for a material misstatement in the 2016/17 financial statements.</p> | <p>We liaised with officers and carried out substantive testing in order to gain assurance that the transfer of information between payroll systems was carried out accurately and did not result in a material financial misstatement.</p> | <p>Our work provided the assurance we sought and did not highlight any material issues to bring to your attention.</p> |

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. We did not identify any deficiencies that required reporting to Members

Value for Money conclusion

Value for Money conclusion

Unqualified

Summary of our work

We are required to form a conclusion as to whether the Council 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.

The following table provides commentary of our findings in respect of each of the sub-criteria and an indication as to whether proper arrangements are in place.

| Sub-criteria | Commentary | Arrangements in place? |
|--------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|
| Informed decision making | <p>During the year there has been a change in senior positions at the Council with both a new Council Leader and a new Chief Executive now in place.</p> <p>The Council has a clear governance structure which is regularly reviewed and where necessary adjusted to remain fit for purpose. A formal constitution is in place setting out the scheme of delegation for decisions which was last updated in September 2016 and is available on the Council's website.</p> <p>The Council's 2016/17 Annual Governance Statement provides a summary of the governance and management arrangements in place to ensure informed decision-making and explains how assurance on the effectiveness of these arrangements in the year has been provided to the Audit and Standards Committee.</p> <p>The Council Plan, is in place for the period 2015 to 2020 setting out how the Council will play its part in realising Vision 2030 which is Gateshead's Sustainable Community Strategy, produced with a wide range of partners and others with a stake in the area.</p> | Yes |

| Sub-criteria | Commentary | Arrangements in place? |
|-----------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|
| Sustainable resource deployment | <p>Council formally approve the 2016/17 budget at their meeting on 25 February 2016. Included within the approved Budget was a requirement to achieve savings of £18.8 million during the year (see below for the results of our work on these savings).</p> <p>Cabinet received a report on 20 June 2017, outlining a final 2016/17 Revenue position of a £1.3 million underspend. This extends the Council's track record of delivering increasingly challenging revenue outturns within the agreed budgets.</p> <p>The Council ended 2016/17 with general reserves of £16.8 million (£16.3 million in 2015/16). There were also £33.8 million of earmarked general fund reserves (£36.7 million in 2015/16). The level of general fund balances is approved annually by Cabinet and Council as part of the MTFS review.</p> <p>A Capital Strategy is in place which reflects the Council's priorities. All capital schemes are appraised and prioritised to ensure they reflect the key investment requirements in the strategy. The capital programme is included as part of the MTFS.</p> <p>The Change Programme will play a critical role in the transformation change and future performance of the Council as the reductions in central government funding continues for the foreseeable future. We comment on the Change Programme in the significant risk section below.</p> | Yes |
| Working with partners and other third parties | <p>The Council has written procedures for procuring products and services, which are within its Constitution. Contract Procedure Rules outline the financial regulations currently in place</p> <p>The Council's risk register includes a strand on partnership working due to the importance of this area. It is involved in a number of significant partnerships, including:</p> <ul style="list-style-type: none"> • South Tyne and Wear Waste Management Partnership: This partnership was established to procure a service for treating and disposing of residual municipal waste. In April 2011, the partnership signed a £727 million PFI contract with a consortium led by SITA UK. 2014/15 was the first year of trading; and • Gateshead Regeneration Partnership: The Council formally appointed Evolution Gateshead as partner in a joint venture vehicle in 2012. This Partnership is part of the Housing Market Renewal and Growth Strategy. Construction is ongoing on the first tranche of sites and the second tranche of sites is also progressing. | Yes |

Significant Value for Money risks

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 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 Value for Money risk. The work we carried out in relation to significant risks is outlined below.

| Value for Money conclusion risk | Work undertaken | Conclusion |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Sustainable resource deployment</p> <p>The Council continues to face financial pressures from reduced funding, increased demand and changing responsibilities. The Council is responding to the challenges by a programme of efficiencies, service reviews and developing new ways to manage demand and deliver services. Failure to have appropriate arrangements in place to identify and deliver this programme poses a significant risk to the Council's ability to deliver its strategic priorities and maintain statutory functions.</p> | <p>We reviewed:</p> <ul style="list-style-type: none"> • monitoring and action plans for a sample of savings included in the budget; • the updated Medium-Term Financial Strategy; • budget monitoring reports and other finance updates; • the progress made in identifying further savings required; and • progress on the Council's Change Programme. | <p>In recent years, the Council has delivered a range of significant savings whilst aiming to minimise impact on service delivery. The level of savings is, however, challenging and there have been decisions made on both the range and the level of services that the Council can deliver.</p> <p>In 2016/17, the Council reported £16.6 million savings whilst also delivering an underspend of £1.3 million.</p> <p>In the 2017/18, the Council has again set a challenging savings target of £13.2 million, made up of several savings plans. Based on our review of the arrangements in place and management's responses to our challenge on the deliverability of a sample of savings plans, whilst acknowledging that this will be an ongoing challenge, we have no issues to report in this area.</p> <p>In addition, the process of working with Directorates to identify savings for the 2018/19 savings, currently identified in the Medium Term Financial Strategy (MTFS), as £20.6 million have begun.</p> <p>The Council's latest MTFS, presented to Cabinet in July 2017, covered the period 2018/19 to 2022/23 and is designed to help ensure resources are aligned to the outcomes in the Council Plan 2015-2020. The MTFS sets the financial context for the Council's resource allocation process and budget setting. Over the five year period the Council faces a funding gap that is currently estimated at £88 million. The size of this shortfall represents a significant challenge to the Council's effective financial planning and medium term financial sustainability.</p> |

Other reporting responsibilities

| | |
|-------------------------------------------------------------------------------|-----------------------------|
| Exercise of statutory reporting powers | Objection received |
| Annual Governance Statement | No matters to report |
| Whole of Government Accounts consistency with the financial statements | Consistent |
| Other information published alongside the 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 which we report by exception

The 2014 Act provides us with specific reporting powers where matters come to our attention that require reporting to parties other than the Council. We have the power to:

- report in the public interest; and
- make statutory recommendations to the Council, which must be responded to publicly.

In addition we must respond to any objections or questions on items contained within the accounts raised by a local government elector. We did not receive any such objections or questions.

We received one objection to the Council's 2016/17 financial statements from a local elector on 6 July 2017. The objection concerned the Council's involvement with borrowing instruments called Lender Option Borrower Options (LOBOs) and were seeking to make formal objections to the statement of accounts. LOBOs give the lender options to increase the interest rates payable by the Council at pre-determined intervals during the term of the borrowing. At these points, the Council also has the option to walk away from the borrowing and look to refinance the debt from alternative sources. Through our discussions with the NAO and other audit suppliers to local government bodies across England, it has become

apparent that similar objections have been received at a number of local authorities.

We were able to determine that the information provided to us by the objector did not give rise to a risk of material error in the Council's financial statements and as such were able to issue an unqualified opinion on the financial statements on 31 July 2017. Our work on the objection is currently ongoing and as such cannot yet issue our certificate formally closing the 2016/17 audit. We anticipate being in a position to do so within the next two months.

We are also required to report if, in our opinion, the Annual Governance Statement does not comply with the guidance issued by CIPFA in 'Delivering Good Governance in Local Government; Framework 2016' or is inconsistent with our knowledge and understanding of the Council. We did not exercise any of our reporting powers during our 2016/17 audit and had no matters to report to the Council in relation to the Annual Governance Statement.

Reporting to the NAO in respect of Whole of Government Accounts

The NAO requires us to report to them whether consolidation data that the Council has submitted is consistent with the audited financial statements, and to undertake specified procedures on that data. We have concluded and reported that the consolidation data is consistent with the audited financial statements.

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 information in the Narrative Report was consistent with the audited financial statements.

Our fees

Fees for work as the Council's appointed auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to Audit and Standards Committee in March 2017.

Having completed our work for the 2016/17 financial year, we can confirm that our final fees are as follows:

| Area of work | 2016/17 proposed fee | 2016/17 final fee |
|------------------------------------------------|----------------------|-------------------|
| Code audit work | £130,298 | £130,298 |
| Certification of Housing Benefit Subsidy Claim | £12,405 | £12,405 |

Please note that our work on the Housing Benefit Subsidy Claim is not yet completed and consequently the final fee quoted above is still on an estimated basis.

We confirm that the fees are in line with the scale fees set by Public Sector Audit Appointments Ltd.

With regard to other non-Code work, we have been commissioned to carry out work in relation to the Pooling of Housing Capital Receipts Return (£1,800) and Teachers' Pensions Return (£3,750).

Future challenges

Financial outlook

The Council has made good progress in addressing the financial challenges from public sector austerity and has a proven track record of strong budget management and delivering planned budget reductions.

In 2016/17, significant additional savings of £16.6 million were delivered and there was also a small underspend against budget.

In recent years, the Council has delivered a range of significant savings whilst aiming to minimise impact on service delivery.

The level of future savings required (estimated to be £88 million over the next 5 years) represents a significant challenge to the Council's effective financial planning and medium term financial sustainability.

Operational challenges

The key challenges for the future include:

- the ongoing delivery of the estimated funding gap identified in the MTFS;
- managing the increases in demand for social care and the impact of welfare reform;
- prioritising local economic growth to generate income to help sustain Council service delivery in key areas. This includes the regeneration work being carried out at the Gateshead Quays and Baltic Business Quarter;
- the impact of the UK's exit from the European Union; and
- delivering change and improvement through the initiatives identified above and others, whilst maintaining sound delivery of day-to-day services, which the Council is seeking to manage through its strategic plan.

How we will work with the Council

We will focus our 2017/18 audit on the risks that these challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money. We will also share with you relevant insights that we have as a national and international accounting and advisory firm with experience of working with other public sector and commercial service providers.

We have worked successfully with your officers to bring forward the accounts and audit timetable ahead of the statutory requirement to do so. We will reflect on the experience this year and seek to make improvements so that the process is further improved for the 2017/18 financial year.