



Annual Audit Letter

Gateshead Council

Year ending 31 March 2018





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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 Gateshead Council (the Council) for the year ended 31 March 2018. 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 31 July 2018 included our opinion that the financial statements:</p> <ul style="list-style-type: none">• gave a true and fair view of the Council's and Group's financial position as at 31 March 2018 and of its expenditure and income for the year then ended; and• had been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 31 July 2018 included our opinion that the other information in the Statement of Accounts was consistent with the audited financial statements.</p>
Value for Money conclusion	<p>Our auditor's report concluded that we were satisfied that in all significant respects, the Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.</p>
Reporting to the group auditor	<p>In line with group audit instructions issued by the NAO, on 29 August 2018 we reported to the group auditor in line with the requirements applicable to the Council's WGA return.</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 and Group's financial position as at 31 March 2018 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 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 2018:

Financial statement materiality	Our financial statement materiality was based on 2% of Gross Revenue Expenditure.	£11,370,440 Council £11,751,120 Group
Trivial threshold	Our trivial threshold was based on 3% of financial statement materiality.	£341,000 Council £353,000 Group
Specific materiality	We applied a lower level of materiality to the following areas of the accounts: <ul style="list-style-type: none">• Members Allowances• Senior Employees Remuneration• Exit Packages	£118,000 £145,000 £432,000

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 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.

Identified significant risk	Our response	Our findings and conclusions
<p>Management override of controls 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 there is a risk of material misstatement due to fraud on all audits.</p>	<p>We addressed this risk through performing audit work over accounting estimates, journal entries and significant transactions outside the normal course of business or otherwise unusual.</p>	<p>Our work provided the assurance sought, with no significant matters arising.</p>
<p>Revenue recognition In accordance with ISA 240 we presume there is a risk of fraud in respect of the recognition of revenue because of the potential for inappropriate recording of transactions in the wrong period. ISA 240 allows the presumption to be rebutted but, given the Council's range of revenue sources, we have concluded that there are insufficient grounds for rebuttal in 2017/18. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.</p>	<p>We evaluated the design and implementation of controls to mitigate the risk of income being recognised in the wrong period.</p> <p>In addition, we undertook a range of substantive procedures including</p> <ul style="list-style-type: none"> • testing receipts in March, April and May 2018 to ensure they had been recognised in the right year; • testing material year end receivables; • testing adjustment journals and obtaining direct confirmation of year-end bank balances; and • testing the reconciliations to the ledger. 	<p>Our work provided the assurance sought, with no significant matters arising.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p>Property, plant and equipment revaluation</p> <p>The financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Council's holding of PPE.</p> <p>Although the Council employs an external valuation expert to provide information on valuations, there remains a high degree of estimation uncertainty associated with the revaluation of PPE due to the significant judgements and number of variables involved in providing revaluations. We have therefore identified the revaluation of PPE to be an area of risk.</p>	<p>We considered the Council's arrangements for ensuring that PPE values were reasonable and used an external expert (Gerald Eve) to provide data to enable us to assess the reasonableness of the valuations provided by the Council's valuer.</p> <p>We assessed the competence, skills and experience of the valuer.</p> <p>We also performed further audit procedures on individual assets to ensure that the basis and level of revaluation was appropriate.</p>	<p>Our work identified two misstatements, with a total value of £6.147 million, that the Council chose not to amend.</p> <p>We concluded that we had sufficient assurance that PPE revaluations would not result in a material misstatement in the Council's accounts.</p>
<p>Defined benefit liability valuation</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 includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.</p>	<p>We discussed with key contacts the significant changes to the pension estimates.</p> <p>In addition to our standard programme of work in this area, we evaluated the management controls 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 was carried out annually by the NAO's consulting actuary (PWC).</p>	<p>Our work identified misstatements, all of which were amended. These related to The Gateshead Housing Company.</p> <p>Following amendments, we concluded that we had sufficient assurance that the defined benefit liability valuation would not result in a material misstatement in the Council's accounts.</p>
<p>Management judgement Group Accounts Assessment</p> <p>Following changes to the activities undertaken by the Council, for example the Gateshead Energy Company, management need to reassess their group boundary and determine the need to produce group accounts for 2017/18 in line with the CIPFA code. Management revisit this assessment annually based on current and latest up to date information to determine if the group financial accounts are required. There is a risk that management will reach the incorrect conclusion regarding the need to produce group financial statements.</p>	<p>The Council carried out an initial review of its boundary and assessed that Group Accounts were not required. Our initial assessment suggested this was not unreasonable in light of our review of the Council's group boundary assessment to ensure that it was complete and all group entities had been identified.</p> <p>On receipt of the most up to date information from the Gateshead Housing Company (TGHC) in relation to pension liability figures in late May 2018, officers assessed that the production of Group Accounts was required. In light of this, the Council consolidated Gateshead Housing Company into group accounts for 2017/18. The Council's view remained that other subsidiaries and associates remained immaterial to the group and therefore did not consolidated those entities into its group</p>	<p>We reviewed the Council's approach and while, consolidating the accounts of all subsidiaries and associates into the group accounts remains our preference, we did not believe there was a risk of material misstatement at group level given the values involved and the enhanced disclosures the Council made in relation to its other interests.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

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 identified the following deficiencies in internal control as part of our audit.

Description of deficiency	As part of our review of Active Directory users (the initial log in to the Council's systems) in March 2018 we identified 25 non system type generic i.e. unnamed accounts, of which 6 had been disabled so could not be used, 10 ,whilst being usable, had not been used in financial year 2017/18, leaving 9 accounts which had been used. None of those generic accounts had administrative access so limited scope as to what they could do on the system.
Potential effects	Inappropriate or fraudulent accesses to IT resource. Fraudulent or unintentional data alteration or entry. Loss of the audit trail / logs of user actions.
Recommendation	In order to avoid unauthorised access to the network, programs and data, we recommend closely monitoring the active accounts in order to ensure: <ul style="list-style-type: none">• generic accounts are disabled when not used; and• user access is assigned on a need-to-have basis and disabled once it is not needed.
Management response	Existing processes to monitor inactive accounts to avoid unauthorised access to the network will be reviewed and strengthened. Communication with the business systems owner of the accounts in question will be prioritised to determine why an account has not been used. Monitoring arrangements will be enhance and existing controls strengthened in order to ensure: <ul style="list-style-type: none">• generic accounts are disabled when not used; and• user access is assigned on a need-to-have basis and disabled once it is not needed.

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

Our approach to Value for Money

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 2018, 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 2018.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<p>The Council have clear decision making processes in place along with clear governance structures which are reviewed regularly and updated when necessary to remain fit for purpose.</p> <p>A formal constitution is in place setting out the scheme of delegation for decisions which was last updated in March 2018 and is available on the Council's website.</p> <p>The 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>We have no issues to report on the adequacy of the Council's arrangements to support informed decision-making</p>	Yes
Sustainable resource deployment	<p>The 2017/18 budget was formally approved at the Council meeting on 23 February 2017.</p> <p>The approved budget included a requirement to achieve savings of £13.190 million during the year (see below for the results of our work on these savings).</p> <p>The 2017/18 outturn report was received by Cabinet on 19 June 2018. This outlined an under spend of £1.268m after proposed movement of reserves. This position extends the Council's track record of delivering increasingly challenging revenue outturns within budget.</p>	Yes

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3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment (continued)	<p>The Council ended 2017/18 with general reserves of £13.7 million. A further £36.2 million was also held in earmarked general fund reserves.</p> <p>The Council's Capital Strategy reflects the Council's priorities. The implications of the capital programme are appropriately reflected in the MTFS.</p> <p>In our Audit Strategy Memorandum we identified a significant risk in relation to this criteria. In order to assess the robustness of the Council's plans, we have:</p> <ul style="list-style-type: none"> • completed testing of the achievement of the Council's monitoring and action plans for a sample of savings included in the budget; • reviewed the updated Medium-Term Financial Strategy; • reviewed budget monitoring reports and other finance updates; and • reviewed progress in identifying further savings. <p>Our findings from this work are outlined below.</p> <p>Achievement of 2017/18 savings programme</p> <p>The Councils 2017/18 savings target was £13.190 million of which they achieved savings was £9.344 million i.e. 71% of the target. However, the reported £1.268 million underspend suggests the Council has been effective in delivering compensating savings elsewhere in budgets.</p> <p>We selected a sample of the 2017/18 savings plans and assessed delivery against the target level of savings. In the majority of cases the plans achieved the required saving however in two cases we identified schemes that did not deliver the saving required. These both related to Care, Wellbeing and Learning and were due to a delay in negotiations with key providers. Arrangements are now in place with providers of older people residential and nursing care and ongoing savings are being made.</p> <p>Arrangements for achievement of 2018/19 savings programme</p> <p>Included in the Council's 2018/19 budget, approved by Council on 20 February 2018, is a savings target of £13.650 million. Officers have carried out detailed work in this area and have identified savings plans for a number of individual projects to achieve this target.</p> <p>The same detailed monitoring arrangements for the savings plans remain in place. Based on our review of these arrangements and management's responses to our challenge we have no issues to report however the required savings remains challenging.</p>	

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment (continued)	<p>Review of 2019/20 savings target</p> <p>The Councils medium term financial strategy has identified a 2019/20 funding gap of £29.223 million. The process of working with Directorates to identify savings has already begun, with £10.2 million of potential savings identified to date.</p> <p>Review of the 2019-2024 Medium Term Financial Strategy (MTFS)</p> <p>The Council's updated MTFS was considered and approved by Cabinet on 17 July 2018.</p> <p>The MTFS is based on a financial forecast over a rolling 5 year timeframe from 2019/20 to 2023/24 and is designed to help ensure resources are aligned to the Council's "Making Gateshead a place where everyone thrives" Plan. The refresh of the MTFS including all assumptions, gives an estimated revised funding gap over the 5 year period of £76.7 million with £55 million being over the three-year budget planning period to 2022.</p> <p>This reported shortfall identifies significant challenges to the Council's effective financial planning and medium term financial sustainability.</p>	
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. • Gateshead Regeneration Partnership. 	Yes

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 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 a referral to the Secretary of State where we believe that a decision has led to, or would lead to, unlawful expenditure, or an action has been, or would be unlawful and likely to cause a loss or deficiency; and
- make written recommendations to the Council which must be responded to publically.

We have not exercised any of these statutory reporting powers.

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 submitted this information to the NAO on 29 August 2018.

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 Audit and Standards Committee in March 2018.

Having completed our work for the 2017/18 financial year, we can confirm that our final fees are as follows:

Area of work	2017/18 proposed fee	2017/18 final fee
Delivery of audit work under the NAO Code of Audit Practice*	£130,298	TBC
Certification of Housing Benefit Subsidy Claim	£10,615	Work ongoing

* We are awaiting approval from PSAA for the variation to the scale fee

Our final fee is expected to be higher than the scale fee set by PSAA due to the need to audit the Group Accounts which were included in the Council's financial statements. Discussions have been held with PSAA and we are awaiting approval of our variation request.

Fees for other work

During the year, the Council commissioned us to carry out the work outlined in the table below –

Area of work	2017/18 fee	2016/17 fee
Pooling of Housing Capital Receipts Return	£1,800	£1,800
Gateshead 3-7 School Centred Initial Teacher Training (Gateshead 3-7 SCITT)	£2,250	£2,250
Teachers' Pensions Return	£3,750	£3,750
Schools Funding Agency	£2,000	£2,000

6. FORWARD LOOK

Financial outlook

The Council continues to make 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.

The Council's refreshed MTFS identifies an estimated revised funding gap over the 5 year period of £76.7 million with £55 million being over the three-year budget planning period to 2022. This represents a significant challenge to the Council's effective financial planning and medium term financial sustainability.

Whilst the Council has a good record of delivering savings, £9.344 million delivered in 2017/18, it will become even more become increasingly challenging to deliver the savings required whilst also aiming to minimise impact on service delivery.

Operational challenges

The key challenges for the future include:

- delivery of the five pledges included in the Council's new strategic approach Making Gateshead a Place Where Everyone Thrives
- the ongoing delivery of the estimated funding gap identified in the MTFS along with the potential financial instability which Brexit may bring
- managing the cost increases in the care sector as a result of the increases in the number and rising need levels of both adults and children; and
- 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;

How we will work with the Council

We will focus our 2018/19 audit on the risks that the above challenges present to the Council's financial statements and ability to maintain proper arrangements for securing value for money. We will also share with the Council and appropriate staff 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 will have a 'lessons learnt' session with the finance team to carry out a review of the 2017/18 earlier deadline and identify anything that could be done better and quicker

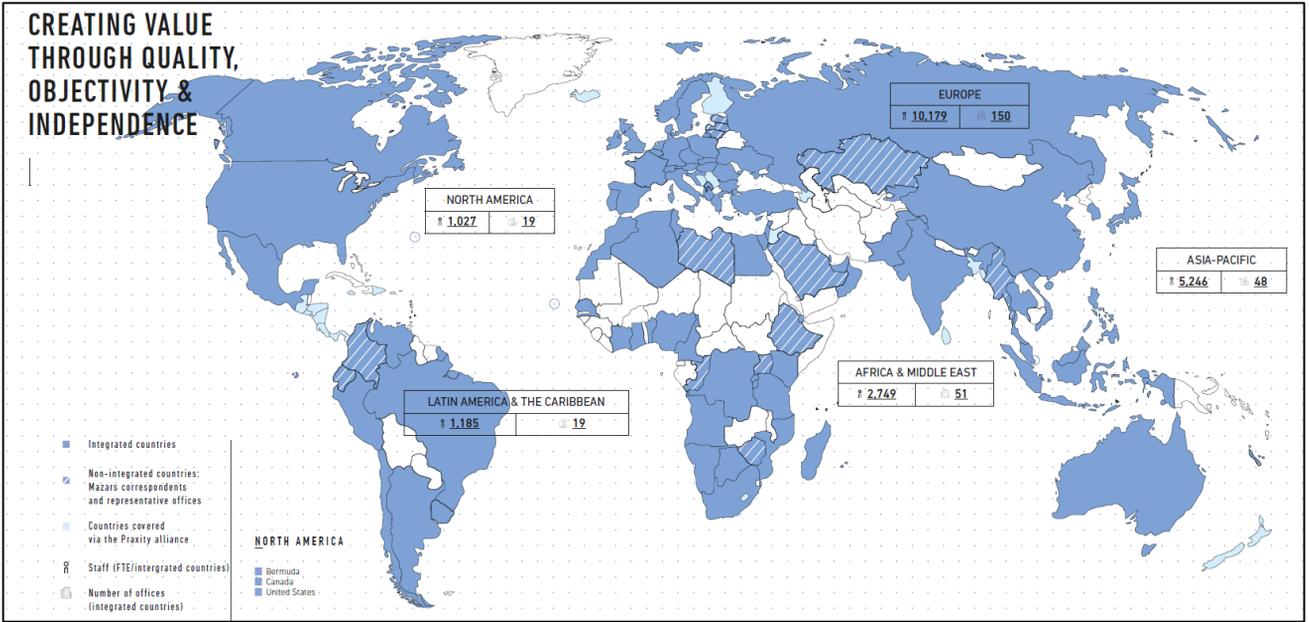
In terms of the technical challenges that the finance team face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise.

MAZARS AT A GLANCE

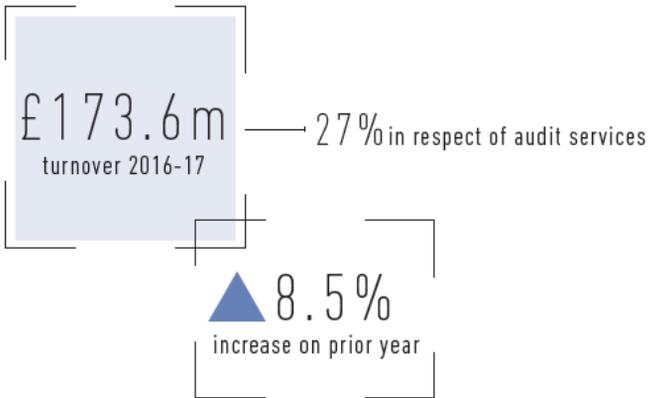
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Mazars Internationally



Mazars in the UK



As at 31 August 2017

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