



Fylde Borough Council

Report to the Audit and Standards Committee on the
audit of the year ended 31 March 2019

Issued 22 July 2019 for the meeting on 30 July 2019

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Director introduction

The key messages in this report:

I have pleasure in presenting our report to the Audit and Standards Committee for the 2019 audit. I would like to draw your attention to the key messages of this paper:

Status of the audit

Our audit is substantially complete subject to completion of the following principal matters:

- receipt of one bank letter;
- receipt of audit letter from the auditor of Lancashire County Pension Fund;
- finalisation of valuation review;
- notes testing including cash flow and reserves;
- review of events since 31 March 2019 up to signing of accounts;
- finalisation of the Statement of Accounts;
- completion of internal quality assurance procedures including follow-up queries arising from these; and
- receipt of signed management representation letter.

Conclusions from our testing

The key judgements in the audit process related to:

- Completeness and cut-off of service line expenditure – as there is an inherent fraud risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position;
- Property Valuation – as the determination of property valuation is highly subjective and there is a risk the value of property assets materially differ from the year-end value.
- Management override of controls – in particular judgements taken by management during the year around accounting estimates, any significant transactions and the journals process.

We have identified an error whereby the gross income and expense in the comprehensive income and expenditure statement whereby income and expenditure were both overstated in relation to support service recharges. The Council have corrected the accounts and restated the prior year comparatives in this regard. We also identified material errors relating to property valuations which we worked with the Council to resolve, including the Council engaging their own external expert to give their opinion on relevant valuations.

Director introduction

The key messages in this report (continued):

Conclusions from our testing (continued)	<p>Based on our work completed to date we have not identified any other errors or omissions resulting in material audit adjustments or disclosure deficiencies.</p> <p>Discussion of audit insights and recommendations, and of unadjusted immaterial misstatements, are discussed on pages 12 and 17 respectively. These do not prevent us issuing a clean audit opinion based on our procedures completed to date.</p>
Financial sustainability and Value for Money	<p>We have not identified any significant risks in relation to Value for Money. We are satisfied that the Council has made proper arrangements for securing financial resilience and economy, efficiency, and effectiveness in its use of resources. Value for Money is discussed further on page 11.</p>
Narrative Report & Annual Governance Statement	<p>We have reviewed the Council's Narrative Report & Annual Governance Statement to consider whether it is misleading or inconsistent with other information known to us from our audit work.</p> <p>The Annual Governance Statement complies with the Delivering Good Governance guidance issued by CIPFA/SOLACE.</p> <p>We have no matters to raise with you in respect of the Narrative Report.</p>
Duties as public auditor	<p>We did not receive any queries or objections from local electors this year.</p> <p>We have not identified any matters that would require us to issue a public interest report. We have not had to exercise any other audit powers under the Local Audit and Accountability Act 2014.</p>
Whole of Government Accounts	<p>The Council is not a sampled component for WGA reporting.</p> <p>We are required to perform testing on the Council's WGA submission, checking its consistency to the audited financial statements and reporting our findings to the National Audit Office (together with our audit opinion and key issues from our audit). This will be completed later in the year.</p>

Paul Hewitson
Lead audit director

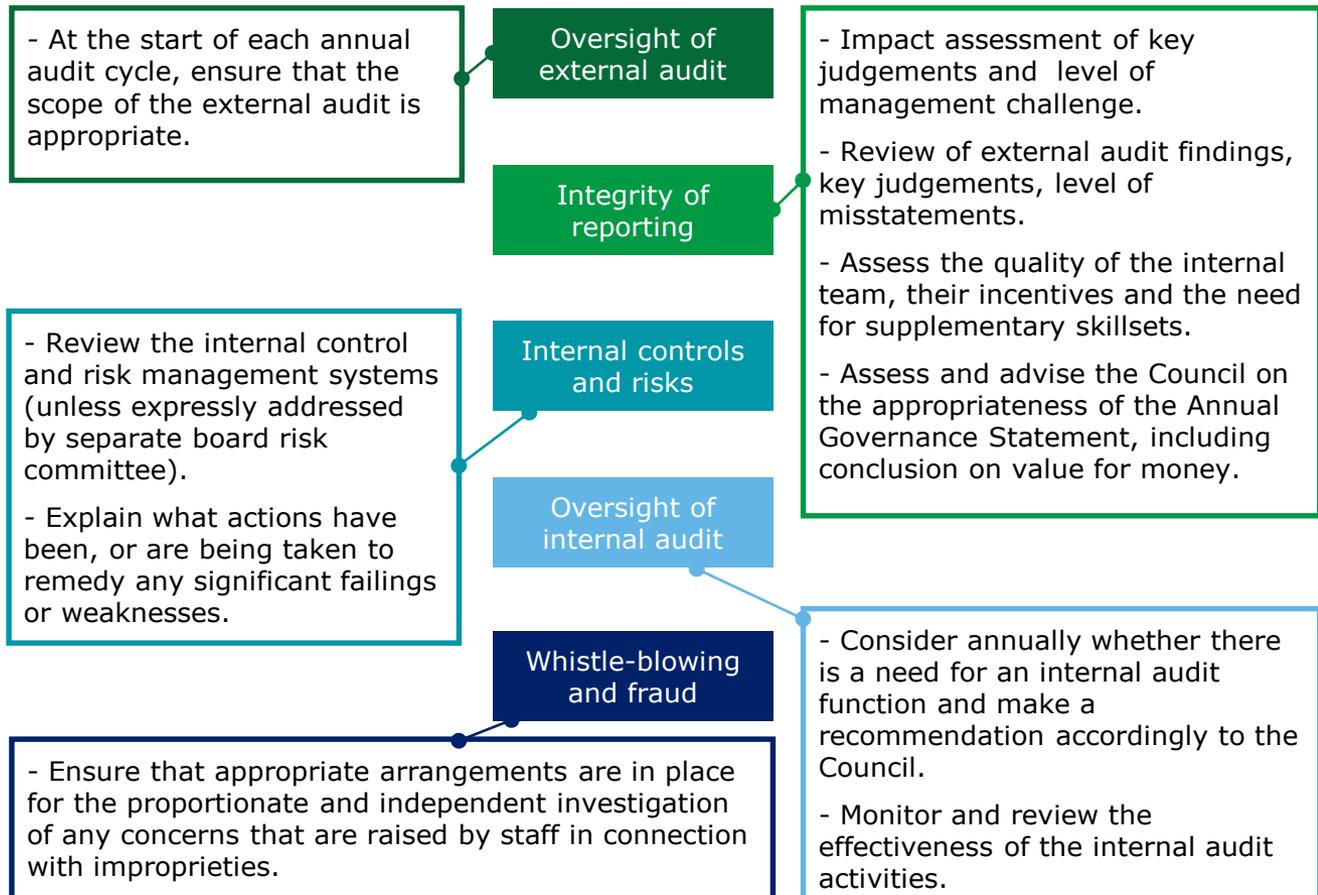
Responsibilities of the Audit and Standards Committee

Helping you fulfil your responsibilities

Why do we interact with the Audit and Standards Committee?

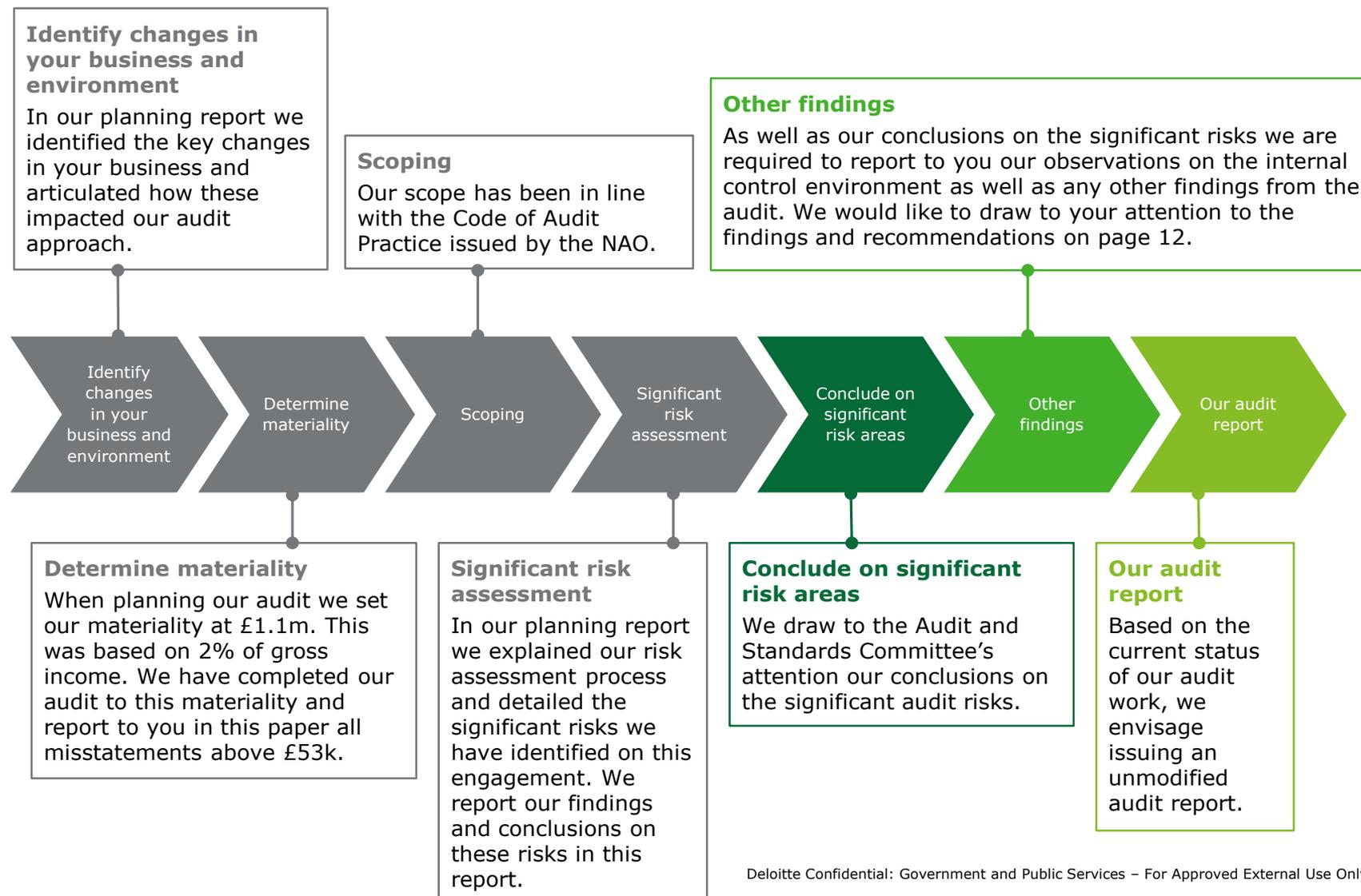


As a result of regulatory change in recent years, the role of the Audit and Standards Committee has significantly expanded. We set out here a summary of the core areas of Audit and Standards Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit and Standards Committee in fulfilling its remit.



Our audit explained

We tailor our audit to your business and your strategy



Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls	Conclusion on D&I work	Consistency of judgements with Deloitte's expectations	Slide no.
Completeness and Cut off of service line expenditure			D+I	Satisfactory		8
Property valuations			D+I	Satisfactory		9
Management override of controls			D+I	Satisfactory		10

Overly prudent, likely to lead to future credit      Overly optimistic, likely to lead to future debit.

D+I: Assessing the design and determining the implementation of key controls

Significant risks

Completeness and cut off of service line expenditure

Risk identified	<p>Under UK auditing standards, there is a presumed risk of revenue recognition due to fraud. We have rebutted this risk, and instead believe that the fraud risk lies with the completeness and cut-off of service line expenditure. We identify this as expenditure excluding payroll costs, depreciation and amortisation and expenditure which is grant backed (such as Housing Benefit expenditure).</p> <p>There is an inherent fraud risk associated with the recording of expenditure in order for the Council to report a more favourable year-end position.</p> <p>There is a risk that the Council may materially misstate expenditure through manipulating the year end position in order to report a more favourable outturn.</p>
Deloitte response	<p>We obtained an understanding of the design and implementation of the key controls in place in relation to recording completeness and cut-off of service line expenditure (excluding payroll, depreciation and amortisation, and expenditure which is grant backed);</p> <p>We performed focused testing in relation to the completeness and cut-off of service line expenditure (excluding the areas set out above) including detailed reviews of provisions and accruals; and,</p> <p>We reviewed and challenged the assumptions made in relation to year-end estimates and judgements to assess completeness and accuracy of recorded service line expenditure.</p>
Conclusion	<p>We have identified no errors in our testing of completeness and cut off of service line expenditure, and have noted no issues with managements judgements in relation to this balance. We are therefore satisfied that the financial statements are not materially misstated in relation to this risk.</p>

Significant risks

Property valuations

Risk identified	<p>The Council held £19.9m of property, plant and equipment assets at 31 March 2017 which increased to £23.5m as at 31 March 2018. The increase was in part due to additions of £5.3m and depreciation of £1.1m.</p> <p>The 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. As a result of this, however, individual assets may not be revalued for four years.</p> <p>There is therefore a risk that that the value of property assets materially differ from the year end fair value.</p>
Deloitte response	<p>We tested the design and implementation of key controls in place around the property valuation, and how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation;</p> <p>We reviewed revaluations performed in the year, and assessed whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals;</p> <p>We reviewed the approach used by the Council to assess the risk that assets not subject to revaluation are materially misstated;</p> <p>We utilised our valuation specialists, Deloitte Real Estate, to support our review and challenge the appropriateness of the Council's assumptions on its asset valuations as at 31 March 2019; and</p> <p>We tested a sample of revalued assets and re-performed the calculation assessing whether the movement has been recorded through the correct line of the accounts.</p>
Conclusion	<p>We have identified several issues in the Council's processes around property valuation. We have made several recommendations to management and have summarised these on page 12. We had significant concerns over the valuation of St Annes swimming pool, and in addressing this, Fylde engaged a third party valuation firm to assist in preparing their valuation. As a result of this, the pool valuation was adjusted from £6m to £3.9m.</p> <p>Different assets are valued under different methodologies and the pool is valued on the Depreciated Replacement Cost (DRC) model. Due to the issues identified on the pool valuation, Fylde also commissioned the external valuation firm to revalue the Crematorium and Cemetery, as this is the other asset in Fylde's portfolio valued on a DRC basis. The valuation on this asset reduced from £2m to £1.4m.</p> <p>Fylde have corrected the accounts in respect of these issues. We are satisfied the property valuation figures in the final statement of accounts is not materially misstated.</p>

Significant risks

Management override of controls

Risk identified	<p>In accordance with ISA 240 (UK and Ireland) management override of controls is a significant risk for all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.</p> <p>The key judgements in the financial statements include those which we have selected to be the significant audit risks, (completeness and cut-off of service line expenditure and the Council's property valuations) and any one off and unusual transactions where management could show bias. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.</p>
Deloitte response	<p>In considering the risk of management override, we have performed the following audit procedures that directly address this risk:</p> <p>We tested the design and implementation of key controls in place around journal entries and key management estimates;</p> <p>We risk assessed journals and selected items for detailed testing. The journal entries were selected using computer-assisted profiling based on areas which we considered to be of increased interest;</p> <p>We reviewed accounting estimates for biases that could result in material misstatements due to fraud; and,</p> <p>We obtained an understanding of the business rationale of significant transactions that we became aware of that are outside of the normal course of business for the Council, or that otherwise appeared to be unusual, given our understanding of the entity and its environment.</p>
Conclusion	<p>We identified no issues in our testing of management override. We are satisfied the financial statements are not materially misstated due to management override.</p>

Value for Money

We have not identified any VfM significant risks

Background

Under the National Audit Office's Code of Audit Practice, we are required to report whether, in our opinion, the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The Code and supporting Auditor Guidance Notes require us to perform a risk assessment to identify any risks that have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. We are required to carry out further work where we identify a significant risk - if we do not identify any significant risks, there is no requirement to carry out further work.

Deloitte risk assessment

- We obtained an understanding of the Council's Medium Term Financial Strategy, and budget for 2019/20.
- We considered the appropriateness of the governance arrangements and due diligence performed around the costal defence project.
- We discussed the Council's arrangements with Paul O'Donoghue (s151 officer) and Tracy Manning (Director of Resources).
- We reviewed the Council's draft Narrative Report, Annual Governance Statement and relevant Council papers and minutes.
- We considered the Council's financial results for the year and the assumptions in the budget for future years.
- We considered matters identified by the National Audit Office as potential value for money risks for Councils for 2018/19.

Deloitte view

We have identified minor observations, for example the absence of operational risk monitoring. These are discussed further on slide 14, but determined these were not sufficiently significant to impact our judgement around VfM.

Based upon the work performed in our risk assessment, we did not identify any significant audit risks and have identified no significant concerns regarding the Council's arrangements to secure economy, efficiency, and effectiveness.

Other significant findings

Insights and recommendations

During the course of our audit we have identified a number of insights and recommendations, which we have included below for action.

	Observation	Deloitte recommendation	Management response, responsible officer, and deadline
Methodology and evidence based property valuations	We noted during our work on property valuations that there were areas where the valuations produced by Fylde were not fully in line with RICS methodology and lacked rigorous workings and evidence base to support the valuation figures.	We recommend the Council considers its approach to performing valuations, and ensures that going forward all valuations are done in sufficient detail that an independent valuation expert can understand and re-perform the valuation.	We will review the approach to performing valuations to ensure that going forward valuations provide sufficient detail to meet RICS standards. Head of Technical Services / Oct 2019
Review of property valuations	Property valuations are carried out by a RICS qualified in-house valuer. There is currently no review of these valuations by a second qualified valuer to assess the reasonableness and appropriateness of assumptions made.	We recommend the Council implements processes whereby property valuations are subject to review by qualified valuers. This will help to ensure valuations are prepared in line with RICS guidance, and in a sufficiently rigorous and evidence based manner to ensure property valuations are materially accurate.	We will implement processes whereby property valuations are subject to review by a second qualified valuer. Head of Technical Services / Dec 2019
Use of external property valuation experts	The valuation of assets revalued under the "DRC" methodology is a complex process. As discussed on slide 9, when Fylde engaged an external expert to look at the Pool valuation it was found to be materially different to the internally prepared valuation. Fylde has just two assets revalued under the "DRC" methodology so is not regularly practiced in performing such valuations.	Noting that Fylde currently has just two assets subject to "DRC" revaluation and these are now not due for revaluation for four years, we recommend that Fylde consider using external experts for such revaluation exercises going forward. Alternatively Fylde could consider revaluing a sample of their assets by an external expert each year to benchmark the work of the internal valuation team against that of the external expert.	We will review the approach to performing valuations and consider the use of external experts for this exercise going forward. Head of Technical Services / Oct 2019

Other significant findings

Insights and recommendations (continued)

	Observation	Deloitte recommendation	Management response, responsible officer, and deadline
Consideration of the value of assets not subject to formal revaluation in the year.	The Council revalues operational land and buildings on a five year rolling cycle. They are required to consider the valuation of assets not subject to revaluation in the year. We understand there is not a formal process by which this is done.	We recommend the Council implements processes whereby the valuation of assets not revalued in the year are considered. For example, the Council could consider the movement in local BICS indices and the impact of these on property values.	We will implement processes whereby the valuation of assets not revalued in the year are considered. Head of Technical Services / Chief Financial Officer / Oct 2019
Review of revaluation accounting entries	Depreciation was mishandled on revalued assets in the accounts, leading to PPE to be understated by £306k. This is largely now corrected and the remaining misstatement is trivial. The finance department has a review process in place around the review of fixed asset accounting entries however it failed to prevent the (immaterial) misstatement.	We recommend the client therefore makes the required changes in 2019/20, including corrections to the revaluation reserve. The finance department should ensure review-type controls are sufficiently detailed to identify such errors going forward.	We will make the required changes in 2019/20 and ensure review-type controls are sufficiently detailed to ensure fixed asset accounting entries are accurate going forward. Chief Financial Officer / Nov 2019
IT environment	Our IT specialists have identified various observations regarding the IT system which we have communicated to management. These cover areas such as IT security, privileged access accounts, data leakage and disaster recovery, and controls around shared IT environments with Blackpool Council.	We recommend the Council reviews its IT systems and policies in light of these observations and consider whether they are satisfied with the safety and security of the IT environment.	We will review the observations identified by the IT specialists and implement any resultant actions in order to ensure satisfaction with the safety and security of the IT environment. ICT Manager / Dec 2019

Other significant findings

Insights and recommendations (continued)

	Observation	Deloitte recommendation	Management response, responsible officer, and deadline
Risk identification and management	The Council has good processes in place to identify strategic risks on an annual basis. We noted during our planning enquiries however that there is an absence of operational risk monitoring. Since year end, we have noted that an operation risk system, "GRACE", is already being introduced by the client and will be rolled out over an 18 month period.	We recommend Fylde ensures the new "GRACE" system of monitoring operation risk is fully implemented and ensure changes are fully bedded into the Council. We recommend the Council reviews the effectiveness of the risk management system at the end of the process, post implementation.	We will ensure that the new "GRACE" system of monitoring operation risk is fully implemented, and we will carry out a post-implementation review. Director of Resources / Nov 2020
Physical verification of fixed assets	Physical verification of assets owned by the council is done on an ad-hoc, service led basis without a formal process.	There should be a formal, periodic physical verification and inspection which is conducted independently of the service areas.	We will implement a process whereby physical verification of assets is formalised. Management Team / Mar 2020
Fully depreciated assets	We have noted a high value of fully depreciated assets. Assets with a gross book value of £4.5m are fully depreciated at year end and have nil net book value.	We recommend the Council reviews it's depreciation policy to ensure it is an accurate reflection of the useful economic lives of its assets. Linking with the previous observation, we recommend the Council ensures these fully depreciated assets are still owned and used by the Council and considers removing them from the accounts if not.	We will review the depreciation policy to ensure it is an accurate reflection of the useful economic lives of assets and remove any unused assets from the accounts. Chief Financial Officer / Oct 2019

Other significant findings

Insights and recommendations (continued)

	Observation	Deloitte recommendation	Management response, responsible officer, and deadline
NNDR appeals provisioning	The NNDR appeals provision is largely calculated by a third party organisation. Fylde make some changes to certain areas of the provision where their local knowledge allows them to, on an ad hoc basis. There is not a formal process for reviewing the appropriateness of the third party calculations.	We recommend the Council formalises its processes for considering the appropriateness of the third party provision calculation, and extends the analysis performed to challenge the third party's figures in doing so.	We will review the process for considering the appropriateness of the third party calculations for the NNDR appeals provision. Chief Financial Officer / Mar 2020

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit and Standards Committee discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA (UK) 260 to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Statement of Accounts.
- Our internal control observations.
- Other insights we have identified from our audit.

The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan.

Use of this report

This report has been prepared for the Audit and Standards Committee and the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Committee.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP
Newcastle | July 2019

Appendix 1: Audit adjustments

Unadjusted misstatements

The following uncorrected misstatements have been identified up to the date of this report which we request that you ask management to correct as required by ISAs (UK). Uncorrected misstatements decrease surplus on the provision of services by £0.1m, and increase other comprehensive income by £0.1m.

		Debit/ (credit) Surplus on provision of services £m	Debit/ (credit) in net assets £m	Debit/ (credit) OCI/Reserves £m
Depreciation on revalued assets	[1]	(0.1)	-	0.1

[1] Property revaluations are effective 31 March 2019. Therefore the depreciation charge for the year for these assets should be based on the pre-valuation asset values. Fylde have calculated depreciation based on the revalued asset values and therefore depreciation is overstated. Within the PPE note, The Depreciation Charge line is misstated by a £130k credit, the Impairment Losses line is misstated by a £15k debit, and the Depreciation written out to the revaluation reserve line is misstated by a £115k debit,

Appendix 1: Audit adjustments

Corrected misstatements

The following misstatements have been identified up to the date of this report which have been corrected by management. We nonetheless communicate them to you to assist you in fulfilling your governance responsibilities, including reviewing the effectiveness of the system of internal control.

		Debit/ (credit) Surplus on provision of services £m	Debit/ (credit) in net assets £m	Debit/ (credit) OCI/Reserves £m
Gross-up of CIES for support service recharges – current year	[1]	8.6 (8.6)		
Gross-up of CIES for support service recharges – prior year	[1]	9.4 (9.4)		
Pension liabilities - McCloud	[2]	0.9	(0.9)	
Property valuations	[3]		(2.4)	2.4
Gross up of pension net interest expense	[4]	1.6/(1.6)		
Total		0.9	(3.3)	2.4

[1] Under the CIPFA code, which was clarified in the current year, income and expenditure in the comprehensive income and expenditure statement should not include internal recharges. Fylde included these in income in the prior year, and in the pre-audit draft accounts in the current year. This incorrectly inflated income and expenditure in the prior year by £9.4m, and in the current year by £8.6m.

[2] The McCloud judgement relates to pension liabilities and age discrimination in the transitional arrangements made when moving the pension schemes similar to the Local Government Pension Scheme from final salary to career average benefit arrangements. Subsequent work by the actuary post-year end indicated an additional £0.9m of liability should be recognised at year end to reflect this.

[3] We identified several issues with the property valuation process which resulted in Fylde engaging an external valuation firm to re-perform two valuations during the audit. The result of these revaluations was to reduce the value of Fylde's assets (the St Annes pool and the cemetery/crematorium) by £2.4m.

[4] The Council has a net interest expense on the pension scheme of £0.6m, which is made up of interest income in respect of plan assets of £1.6m, and interest expense in respect of plan liabilities of £2.2m. These were initially shown gross within the "Financing and Investment Income and Expense" line of the CIES, but should be shown net. The Council have corrected this.

Appendix 2: Fraud responsibilities and representations

Responsibilities explained



Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.



Required representations:

We have asked the Audit and Standards Committee to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity or group.

We have also asked the Committee to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



Audit work performed:

In our planning report we identified the risk of fraud in completeness and cut off of service line expenditure and management override of controls as a key audit risk for your organisation.

During course of our audit, we have had discussions with management and those charged with governance.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements

We have reviewed the paper prepared by management for the Audit and Standards Committee on the process for identifying, evaluating and managing the system of internal financial control.

Concerns:

No concerns were noted around the representations from management or our work conducted around the risk of fraud in the financial statements.

Appendix 3: Independence and fees

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit and Standards Committee for the year ending 31 March 2019 in our final report to the Audit and Standards Committee.

Fees

Owing to the issues encountered in respect of the Authorities asset valuations, the treatment of the McCloud judgement in respect of the pensions and various issues and error detected in the financial statements and control environment significant unplanned work has been required on to deliver the audit, with substantially more input required from our in house valuation and actuarial specialists.

We will be holding discussion with management to agree recovery of these additional costs. Any additional fees agreed with management is then subject to review and approval by PSAA, we will report the final agreed position back to the audit committee once resolved.

Non-audit services

There are no non-audit fees other than the £10.5k Housing Benefit work.

In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

Relationships

We have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Appendix 3: Independence and fees (continued)

The professional fees expected to be charged by Deloitte in the period from 1 April 2018 to 31 March 2019 are as follows:

	Current year £
Financial statement audit including Whole of Government and procedures in respect of Value for Money assessment	36,729
Total audit	36,729
Audit related assurance services	10,500
Total assurance services	10,500
Total fees	47,229



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