

# Annual Audit Letter

Isle of Wight Council

October 2014

Ernst & Young LLP



The Members  
Isle of Wight Council  
County Hall  
Newport  
Isle of Wight  
PO30 1UD

24 October 2014

Dear Members,

## **Annual Audit Letter**

The purpose of this Annual Audit Letter is to communicate to the Members of Isle of Wight Council and external stakeholders, including members of the public, the key issues arising from our work which we consider should be brought to their attention.

We have already reported the detailed findings from our audit work to those charged with governance of the Council in the following reports:

Isle of Wight Council audit results report for  
year ended 31 March 2014

Issued 12 September 2014 and presented to  
the Audit Committee on 25 September 2014

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Isle of Wight Pension Fund audit results  
report for the year ended 31 March 2014

Issued 8 September 2014 and presented to  
the Audit Committee on 25 September 2014

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The matters reported here are the most significant for the Authority.

I would like to take this opportunity to thank the officers of Isle of Wight Council for their assistance during the course of our work.

Yours faithfully

Kate Handy  
For and behalf of Ernst & Young LLP  
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In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and audited bodies' (Statement of responsibilities). It is available from the Chief Executive of each audited body and via the [Audit Commission's website](#).

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

**Our Complaints Procedure** – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

## 1. Executive summary

Our 2013/14 audit work has been undertaken in accordance with the Audit Plans we issued on 15 April 2014 for the Council, and 13 June 2014 for the Pension Fund. It is conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

The Authority is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. In the Annual Governance Statement, the Authority reports publicly on an annual basis on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period. The Authority is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As auditors we are responsible for:

- ▶ forming an opinion on the financial statements;
- ▶ reviewing the Annual Governance Statement;
- ▶ forming a conclusion on the arrangements that the Authority has in place to secure economy, efficiency and effectiveness in its use of resources; and
- ▶ undertaking any other work specified by the Audit Commission.

Summarised below are the conclusions from all elements of our work:

Audit the financial statements of Isle of Wight Council and its Pension Fund for the financial year ended 31 March 2014 in accordance with International Standards on Auditing (UK & Ireland)	On 26 September 2014 we issued an unqualified audit opinion in respect of the Authority. On 26 September 2014 we issued an unqualified audit opinion in respect of the Pension Fund, and on the financial statements contained in the Pension Fund Annual Report.
Form a conclusion on the arrangements the Authority has made for securing economy, efficiency and effectiveness in its use of resources.	On 26 September 2014 we issued an unqualified value for money conclusion.
Issue a report to those charged with governance of the Authority (the Audit Committee) communicating significant findings resulting from our audit.	On 12 September 2014 we issued our report in respect of the Authority.  On 8 September 2014 we issued our report in respect of the Pension Fund.
Report to the National Audit Office on the accuracy of the consolidation pack the Authority is required to prepare for the Whole of Government Accounts.	We reported our findings to the National Audit Office on 26 September 2014.
Consider the completeness of disclosures in the Authority's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work and consider whether it complies with CIPFA / SOLACE	No inconsistencies to report, however, we raised the issue that the statement lacked a clear action plan for the mitigation of items raised as significant risks.

guidance.

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Consider whether, in the public interest, we should make a report on any matter coming to our notice in the course of the audit.	No issues to report.
Determine whether any other action should be taken in relation to our responsibilities under the Audit Commission Act.	No issues to report.
Issue a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission.	On 26 September 2014 we issued our audit completion certificate.

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## 2. Key findings

### 2.1 Financial statement audit

We audited the Authority's Statement of Accounts in line with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission. We issued an unqualified audit report on 26 September 2014.

#### Council's financial statements

In our view, the quality of the process for producing the accounts, including the supporting working papers was good.

The main issues identified as part of our audit were:

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#### Significant risk 1: Localisation of Business Rates

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##### Issue:

- ▶ There were significant changes in the arrangements for business rates from April 2013. The detailed accounting arrangements were not clear, presenting an audit risk.
- ▶ One of the main changes was that individual councils needed to provide for rating appeals. This includes not only claims from 1 April 2013 but claims that relate to earlier periods. As appeals are made to the Valuation Office, Councils may not be aware of the level of claims and may also find it difficult to obtain sufficient information to establish a reliable estimate.

##### Findings:

- ▶ The Council's accounting for the new business rate framework, and its disclosures, were in accordance with the CIPFA Code of Accounting Practice.
  - ▶ We assessed the Council's method to estimate its appeals provision, and have not judged it to be an unreasonable estimation method
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#### Significant risk 2: Highways PFI

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##### Issue:

- ▶ The Council's Highways PFI commenced operations on the 1 April 2014. Initial disclosures were made in the 2012/13 financial statements, but the 2013/14 statements needed to include the full accounting requirements to comply with the CIPFA Code.

##### Finding:

- ▶ We reviewed the Council's Highways PFI accounting model, identifying some amendments to ensure compliance with the Code of Accounting Practice requirements, and consistency with the operator's model.
  - ▶ The Council made the adjustments, and also amended the significant resulting impacts on the financial statement disclosures for the Highways PFI.
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#### Significant risk 3: Risk of management override

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##### Issue:

- ▶ In all audits we recognise the risk that management is in a unique position to perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

##### Finding:

- ▶ Our work did not identify indications of management override, including for the pension
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fund.

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### **Pension Fund financial statements**

We again assessed that the quality of the process for producing the accounts, including the supporting working papers to be good.

The main issues identified as part of our pension fund audit were:

#### **Significant risk 1: Transition from Schroder equities to Baillie Gifford diversified growth fund**

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##### **Issue:**

- ▶ The Fund's investment holdings have changed from 2012/13, with approximately 15% of the value of the Fund moving from an equities portfolio managed by Schroder Investment Management to a diversified growth fund managed by Baillie Gifford

##### **Findings:**

- ▶ Processes and controls for the transition were designed and implemented effectively to mitigate risk of material error.
  - ▶ The accounting for the transition has been properly reflected in the financial statements.
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## **2.2 Value for money conclusion**

We are required to carry out sufficient work to conclude on whether the Authority has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

In accordance with guidance issued by the Audit Commission, in 2013/14 our conclusion was based on two criteria:

- ▶ The organisation has proper arrangements in place for securing financial resilience; and
- ▶ The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

We issued an unqualified value for money conclusion on 26 September 2014.

We noted the following issues as part of our audit.

#### **Key finding 1: Financial Resilience**

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- ▶ The financial position of the Council is challenging, but it continues to have arrangements in place to secure financial resilience.
  - ▶ The forecast medium term financial position is that cumulative savings of £28m are required up to the 2016/17 financial year. This is a significant pressure that is to be managed over the whole period.
  - ▶ Based on the track record of achieving budgets and identifying and delivering savings, our judgement is that the Council continues to have the arrangements in place to deliver financial resilience. However, the scale of the challenge is such that there is little if any head-room. Significant decisions need to be taken, and there is limited, if any, time to defer them.
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#### **Key finding 2: Managing risk and improving data quality**

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- ▶ In 2012/13 we gave an 'except for' VFM conclusion related to our judgement of weaknesses in managing risk and data quality. These stemmed from the assessments made by Ofsted of the Council's children's safeguarding and schools improvement services.
  - ▶ There is evidence that the Council has acted on the prior year findings. Corporate arrangements have been refreshed for both managing risk and data quality, including developing the quarterly corporate performance report and the assessment of strategic risks.
  - ▶ The Corporate Plan implemented from March 2014 updated the priorities of the Council. However, in the supporting performance measures there is still scope for improvement in ensuring that these provide a measure of the intended outcome. Improving this focus is a key part of the transformation programme, and an inherent part of developing a commissioning-focused organisation.
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## **2.3 Objections received**

We received no objections to the 2013/14 accounts from members of the public.

## **2.4 Whole of government accounts**

We reported to the National Audit office, on 26 September 2014, the results of our work performed in relation to the accuracy of the consolidation pack the Authority is required to prepare for the whole of government accounts.

We did not identify any areas of concern

## **2.5 Annual governance statement**

We are required to consider the completeness of disclosures in the Authority's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it complies with CIPFA / SOLACE guidance.

The statement contained disclosure of the significant risks facing the Council. However, it does not meet the requirement to set out the action plan and timescales to address the issues.

The lack of a clear action plan does not give the Audit Committee or other stakeholders assurance that there are actions in place to address the significant governance issues identified in the Annual Governance Statement, and also prevents effective monitoring of their remedy by the Committee in line with its overall terms of reference.

## **2.6 Use of other powers**

We identified no issues during our audit that would necessitate using powers under the Audit Commission Act 1998, including reporting in the public interest.



### 3. Control themes and observations

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control we communicated to those charged with governance at the Authority, as required, significant deficiencies in internal control.

The matters reported are shown below and are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported.

Description	Impact
<p>The Council made a payment of £0.5m to Pihl UK Ltd. This was a significant control weakness as the company was in administration at the time of the payment. A cancellation notice had been raised for payments to Pihl UK Ltd, but was not accurately completed due to human error. Lack of secondary review meant the error was not identified.</p> <p>Since identified, the Council has reviewed this payment process.</p>	<p>Recovery of the payment is now linked to the legal processes and claims associated with the administration of Pihl UK Ltd.</p>

## 4. Audit Fees

A breakdown of our fee is shown below.

	Final fee 2013/14 £'000	Planned fee 2013/14 £'000	Scale fee 2013/14 £'000
<b>Total Audit Fee – Code work</b>	<b>166,320</b>	<b>166,320</b>	<b>166,320</b>
Harbours – Agreed upon Procedures <sup>1</sup>	2,511	2,511	
Certification of claims and returns <sup>2</sup>	19,614	19,614	19,614

Our actual fee is in line with the agreed fee.

We undertook no non-audit work at the Council in 2013/14.

*Notes:*

<sup>1</sup> Our work on the annual report and accounts for the Harbours is yet to be completed. The fee requires confirmation by the Audit Commission, so is not yet final.

<sup>2</sup> Our fee for certification of grants and claims is yet to be finalised for 2013/14. We plan to report this to those charged with governance in February 2015 within our Annual Certification Report for 2013/14.

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