

Isle of Wight Council and Isle of Wight Pension Fund

Annual Audit Letter for the year
ended 31 March 2018

August 2018

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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

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

The 'Terms of Appointment (updated 23 February 2017)' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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



01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to Isle of Wight Council (the Council) and Isle of Wight Pension Fund (the Pension Fund) following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's and Pension Fund's:	Unqualified - the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2018 and of its expenditure and income for the year then ended.
▶ Financial statements	
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the consolidation pack.



Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audits.	Our Audit Results Reports for the Council and Pension Fund were issued in July 2018 and presented to the Audit Committee on 30 July 2018.
Issued a certificate that we have completed the audits in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 30 July 2018.

In November 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken. We would like to take this opportunity to thank the Council and Pension Fund's staff for their assistance during the course of our work.

Helen Thompson
Associate Partner
For and on behalf of Ernst & Young LLP



02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Reports to the 30 July 2018 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council and Pension Fund.

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plans for the Council and Pension Fund that we presented to the 19 February 2018 Audit Committee and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2017/18 financial statements, including the pension fund; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



03 Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health. We audited the Council and Pension Fund's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued unqualified audit reports on 30 July 2018. Our detailed findings were reported to the 30 July 2018 Audit Committee.

The key issues identified as part of our audits were as follows:

Significant Risk	Conclusion
Misstatements due to fraud or error	We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements.
The financial statements as a whole are not free of material misstatements whether caused by fraud or error.	We reviewed accounting estimates for evidence of management bias. We evaluated the business rationale for any significant unusual transactions.
As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement. Therefore, this risk was identified on both the Council and Pension Fund audits.	Our work did not identify any: <ul style="list-style-type: none">• material weaknesses in controls or evidence of material management override.• inappropriate journals or adjustments.• instances of inappropriate judgements being applied in relation to accounting estimates, or other balances and transactions.• other transactions during our audit which appeared unusual or outside the Council's and Pension Fund's normal course of business.

Financial Statement Audit (cont'd)

The other key areas of focus identified as part of our audit of the Council, and related findings, were as follows:

Other Key Areas of Focus	Conclusion
<p>Valuation of Land and Buildings</p> <p>The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>	<p>We did not identify any material issues with regard to the valuation of land and buildings.</p>
<p>PFI accounting</p> <p>The Council has one PFI arrangement, which is material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal expert when the PFI was introduced. We reviewed the accounting entries and disclosures in relation to PFI in detail in 2017/18, with a focus on any significant changes since the expert's review.</p>	<p>We did not identify any material issues with regard to PFI accounting.</p>
<p>Pension Asset/Liability Valuation</p> <p>Accounting for the Local Government Pension Scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>We did not identify any material issues with regard to the valuation of pension assets and liabilities.</p>

Financial Statement Audit (cont'd)

The other key areas of focus identified as part of our audit of the Council, and related findings, were as follows: (cont'd)

Other Key Areas of Focus	Conclusion
<p>Restatement of CIES and EFA</p> <p>In 2016/17, CIPFA introduced changes to the Local Authority Accounting Code of Practice, under its "Telling the Story" agenda, which required the Council to disclose its income and expenditure in accordance with the structure used for internal reporting, rather than the previous standardised presentation which was prescribed for all Councils. The Council changed its internal reporting structure in 2017/18, which meant the Comprehensive Income and Expenditure Statement and supporting Expenditure and Funding Analysis needed to be restated in line with the new structure.</p>	<p>We did not identify any material issues with regard to the restatement of the CIES, EFA and related disclosure notes.</p>
<p>Business rates appeals provision</p> <p>The Council is required to make a provision to cover the possibility of successful appeals by ratepayers against the rateable value of their business property, and the commensurate refund of business rates resulting from such appeals. The provision must take into account both appeals lodged to date but not yet decided, and potential appeals yet to be received. The underlying appeals process is subject to a number of factors and as such the estimation of the appeals provision involves significant judgment. This has been further increased by the recent introduction of the new ratings list from 01 April 2017 and changes to the method of making appeals.</p>	<p>We did not identify any material issues with regard to the business rates appeals provision.</p>

Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality for the Council to be £3.745m (2016/17: £3.883m), which is 1% of gross revenue expenditure reported in the accounts of £374.5m. We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.187m (2016/17: £0.194m)

Item	Thresholds applied
Planning materiality	We determined planning materiality for the Pension Fund to be £11.3m (2016/17: £11.2m), which is 2% of net assets reported in the accounts of £562.75m. We consider net assets to be one of the principal considerations for stakeholders in assessing the financial performance of the Pension Fund.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.6m (2016/17: £0.6m)

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. No uncorrected misstatements were identified in either the Council or Pension Fund financial statements.

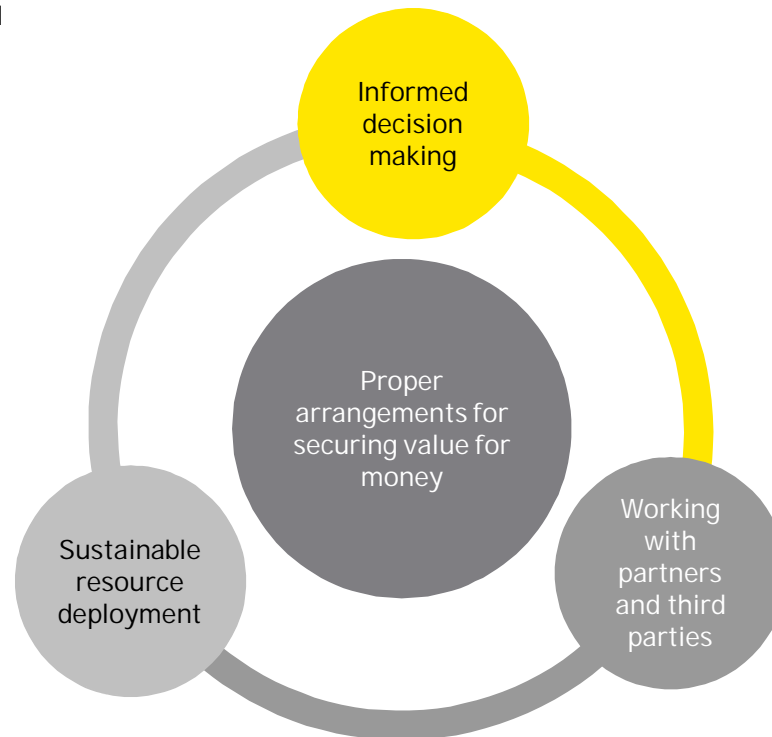


04 Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- ▶ Take informed decisions;
- ▶ Deploy resources in a sustainable manner; and
- ▶ Work with partners and other third parties.



We identified one significant risk in relation to these arrangements. The table below presents the findings of our work in response to the risks identified and any other significant weaknesses or issues to bring to your attention.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We therefore issued an unqualified value for money conclusion on 30 July 2018.



Value for Money (cont'd)

Significant Risk	Conclusion
<p>Progress in achieving medium and longer term financial sustainability</p> <p>The Council continues to face very significant financial challenges as a result of ongoing reductions in funding from central government and increasing demand for high-cost services. It needs to save £7.5 million in 2018/19 in order to achieve a balanced budget, and in the medium term, the Council needs to achieve total savings of £19 million in the period 2018/19 to 2020/21.</p> <p>We noted in our value for money conclusion in 2016/17 that good progress had been made across a number of key areas linked to the Council's current medium term financial strategy, which is intended to address the financial challenges it faces. We also noted the positive outturn position achieved for 2016/17, which had allowed a strengthening of reserves, and that a balanced budget had been set for 2017/18.</p> <p>However, our work in 2016/17 acknowledged that the financial pressures facing the Council are ongoing, and that significant work remained to be done to bring some of the longer-term aspects of the medium term financial strategy to fruition. As such, we judge that the significant risk to the Council's ability to deploy resources sustainably remains present in 2017/18. Our value for money work will therefore focus on the further progress made this year in strengthening the Council's arrangements to ensure financial stability in the longer term.</p>	<p>The Council has continued to make progress against its medium term financial strategy in 2017/18.</p> <p>The outturn position for 2017/18 was positive, allowing reserves for future transformation and capital investment to be strengthened. There was a planned transfer from general reserves in 2017/18 as part of the Council's medium term financial strategy, to enable savings requirements to be "smoothed" over the period covered by the strategy. The 2018/19 budget allows for the general fund balance to be returned to its pre-2017/18 levels.</p> <p>The Council achieved the large majority of savings against identified schemes in 2017/18, with any shortfalls mitigated by savings elsewhere such that no portfolio exceeded its overall budget. Actions have been taken to mitigate the recurrent effect of those identified savings schemes which were below target.</p> <p>A balanced budget has been set for 2018/19 and the assumptions underpinning this and the accompanying refreshed 3-year forecast appear reasonable. All required savings for 2018/19 have been fully identified.</p> <p>Good further progress has been made in 2017/18 against the key underlying elements of the Council's medium term financial strategy, including the 6 key "themes", and the establishment of a regeneration programme.</p> <p>We continue to be mindful of the scale of the financial challenge faced by the Council, and the savings to be achieved in the medium term remain significant. As such, we will continue to keep the Council's ability to deploy resources in a sustainable manner under review going forward.</p>



05 Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.



Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Reports to the Audit Committee on 30 July 2018. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

We adopted a fully substantive approach to both the Council and Pension Fund audits, so we did not test the operation of controls.

In our Audit Results Report for the Council in 2016/17, we noted that we had identified a small number of issues with regard to IT controls, although none of these was sufficiently significant to impact our audit opinion and all points raised had been responded to by management. We have followed up on these issues as part of our 2017/18 audit, and have noted that further action has been taken to address each of the issues identified. We are therefore satisfied that these have been, or are in the process of being, appropriately addressed. No new controls observations were made for the Council in 2017/18.

For the Pension Fund, we identified two controls observations in 2017/18, in relation to correspondence from the Pensions Regulator with regards to inadequate training provided to the Pensions Board, and in relation to issues with membership data passed to the Actuary to facilitate the production of the IAS19 report for the Council. Management have confirmed that both issues will be addressed by the end of 2018/19.



06 Data Analytics



Use of Data Analytics in the Audit

Data analytics – Journals and payroll testing

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- ▶ Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- ▶ Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the Council's and Pension Fund's audits included testing journal entries and employee expenses, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis

We obtain downloads of all LG financial ledger transactions posted in the year. We perform a completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.

Payroll Analysis

We also use our analysers in our payroll testing for the Council. We obtain all payroll transactions posted in the year from the payroll system and perform completeness analysis over the data, including reconciling the total amount to the General Ledger trial balance. We then analyse the data against a number of specifically designed procedures. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation.



07 Focused on your future



Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	<p>Applicable for local authority accounts from the 2018/19 financial year and will change:</p> <ul style="list-style-type: none"> • How financial assets are classified and measured; • How the impairment of financial assets are calculated; and • The disclosure requirements for financial assets. <p>There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.</p>	<p>Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to:</p> <ul style="list-style-type: none"> • Reclassify existing financial instrument assets • Re-measure and recalculate potential impairments of those assets; and • Prepare additional disclosure notes for material items.
IFRS 15 Revenue from Contracts with Customers	<p>Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except:</p> <ul style="list-style-type: none"> • Leases; • Financial instruments; • Insurance contracts; and • For local authorities; Council Tax and NDR income. <p>The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.</p> <p>Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.</p>	<p>As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited.</p> <p>Whilst the standard is not expected to have a material effect, the Council will need to review its existing contracts to ensure it has identified all potential impacts.</p>



Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>



08 Audit Fees

Audit Fees

Our fee for 2017/18 is in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA) and reported in our July 2018 Audit Results Reports. One minor fee variation is proposed for the Council – details are shown below.

Description	Final Fee 2017/18 £	Planned Fee 2017/18 £	Scale Fee 2017/18 £	Final Fee 2016/17 £
Total Audit Fee – Code work (Council)	TBC*	128,054	128,054	128,054
Total Audit Fee – Code work (Pension Fund)	21,085	21,085	21,085	21,085
Total Audit Fee – Certification of claims and returns	TBC**	14,711	14,711	17,078

* We have proposed a scale fee variation of £935, in relation to work done in 2017/18 to review the restatement of the CIES, EFA and associated disclosure notes, arising from changes to the Council's internal reporting structure. This work is outside the scope covered by the 2017/18 scale fee. An equivalent fee has not been charged in previous years. The proposed fee variation remains subject to agreement with management and PSAA.

** Our work on the Council's 2017/18 housing benefit subsidy claim is ongoing. Our final fee will be confirmed following the completion of our work. The deadline for certification of the claim is 30 November 2018.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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