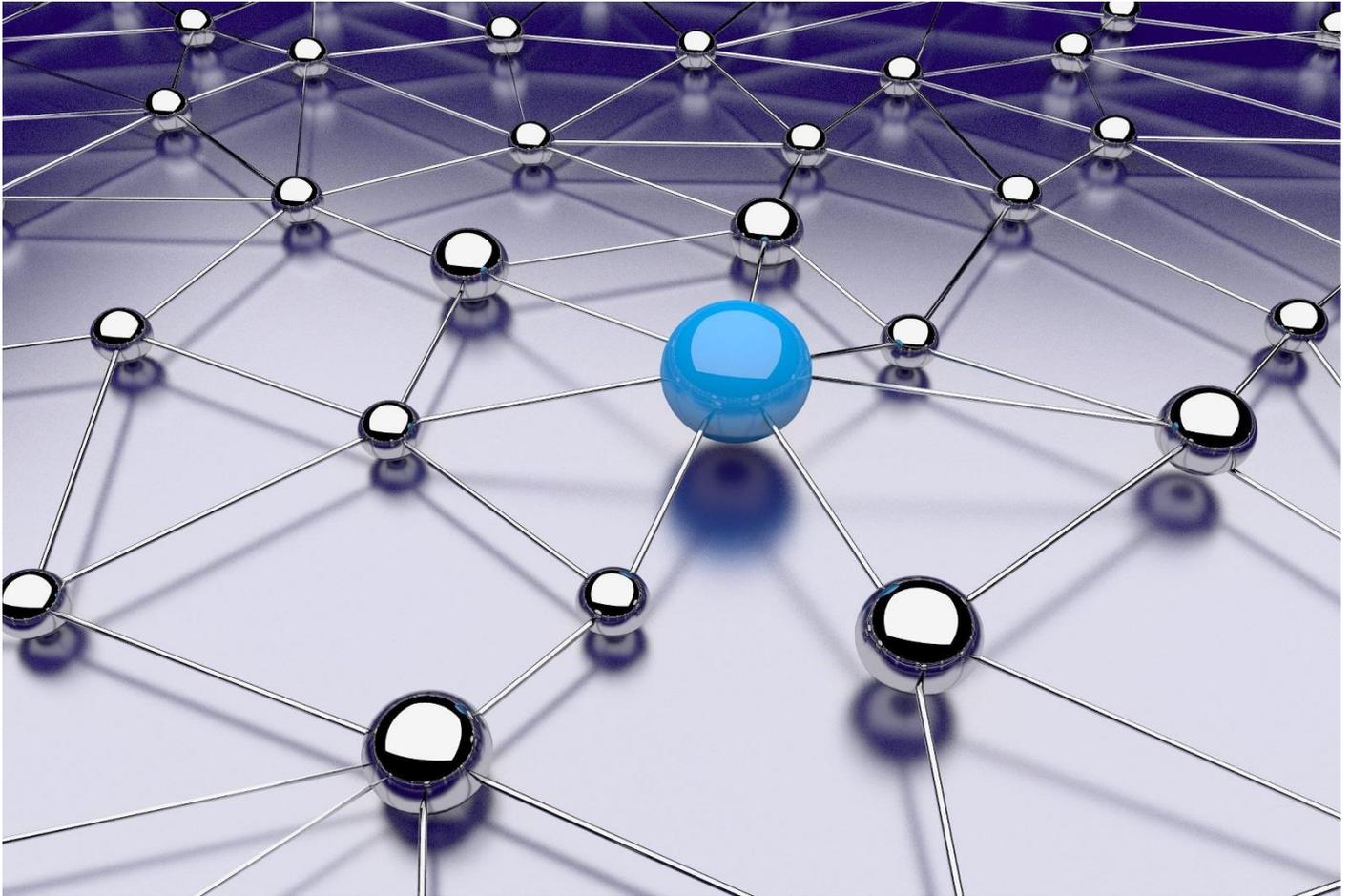


# Gateshead Council

## Annual Audit Letter 2015/16

October 2016



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October 2016

Members  
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Dear Members

**Annual Audit Letter 2015/16**

I am pleased to present our Annual Audit Letter for the 2015/16 audit year. The purpose of this document is to summarise the outcome of the external audit of Gateshead Council's 2015/16 financial statements and our review of your arrangements for securing economy, efficiency and effectiveness (value for money).

We carried out our audit in accordance with the Code of Audit Practice prepared by the Comptroller and Auditor General as required by the Local Audit and Accountability Act 2014.

I would like to express my thanks for the assistance of the finance team, as well as senior officers and the Audit and Standards Committee, during the audit.

If you would like to discuss any matters in more detail then please do not hesitate to contact me on 07979 164467 or [gareth.davies@mazars.co.uk](mailto:gareth.davies@mazars.co.uk)

Yours faithfully

**Gareth Davies**  
Partner  
Mazars LLP

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# 01 Key messages

Our 2015/16 audit of Gateshead Council (the Council) was made up of two elements:

- auditing your financial statements, including a review of the Governance Statement; and
- assessing your arrangements for achieving value for money (VfM) in your use of resources.

We set out the detailed findings from our audit work in our Audit Completion Report which we presented to the Accounts Committee (those charged with governance) and to the Audit and Standards Committee.

We also completed our work on your Whole of Government Accounts return. The key conclusions for each element are summarised below.

## **Audit of the financial statements**

We issued an audit report including an unqualified opinion on the Council's financial statements on 22 September 2016.

The Council's draft statements were available for audit by the end of May 2016 as agreed and were of a good quality, as were the supporting working papers.

We did not encounter any significant difficulties during our audit, and received the full support and cooperation of the finance team.

All errors identified were corrected by management, with the exception of a non-material balancing figure which was included in the draft Cash Flow Statement. Further details are set out in section 02.

## **Value for money**

We carried out our work in line with updated National Audit Office guidance and concluded that the Council has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. We therefore issued an unqualified value for money conclusion on 22 September 2016.

## **Assurance to the National Audit Office**

We issued our certificate, closing this year's audit, on 20 October 2016 on completion of our work on your Whole of Government Accounts return. There were no matters to report.

# 02 Financial statements

## Audit of the financial statements

We audited the Council's financial statements in line with auditing standards and we reported the detailed findings of the audit to the 25 July 2016 Audit and Standards Committee in our Audit Completion Report. In addition, we presented our Audit Completion report, update letter and audit report including an unqualified opinion on the Council's financial statements to the Accounts Committee on 22 September 2016.

As in previous years, the audit progressed smoothly. The Council presented us with draft financial statements at the end of May 2016, well ahead of the national deadline. Our audit was substantially complete by 25 July but the opinion was delayed until we received assurance from the pension fund auditor which was not available until September.

Our audit work identified that a balancing figure of £4.035m was included in the draft Cash Flow Statement. Officers carried out additional work in this area and were able to reduce the balancing figure to £875k. This remains an unadjusted non-material error in the 2015/16 Accounts. Officers amended the draft accounts for all of the other amendments identified during our audit.

Our work on the Council's accounts is designed to provide reasonable assurance that they are free from material misstatement. In performing our audit, we apply the concept of materiality, following the requirements of International Standard on Auditing (UK & Ireland) (ISA) 320: Materiality in planning and performing an audit. Appendix A provides more detail on how we assessed materiality in relation to the Council's 2015/16 financial statements.

Having considered the risks of material misstatement, we identified four areas of significant risk, the first two of which are present in most audits. Our findings in this area are summarised below:

### Management override of controls

#### Description of the risk

In all entities, management at various levels is in a unique position to perpetrate fraud because of the 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, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.

#### How we addressed this risk

Our testing strategy included:

- reviewing material accounting estimates, which may be subject to management bias, included in the financial statements;
- consideration and reviewing of unusual or significant transactions outside the normal course of business; and
- testing of journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

#### Audit conclusion

Our work has provided the assurance we sought and has not highlighted any material issues to bring to your attention.

## Revenue recognition

### Description of the risk

There is a risk of fraud in the financial reporting relating to revenue recognition due to the potential to inappropriately record revenue in the wrong period. We consider revenue recognition to be a significant risk.

### How we addressed this risk

We addressed this risk by performing the following audit work:

- testing cash receipts in the months of March, April and May 2016 to ensure they have been recognised in the right year;
- testing adjustment journals; and
- obtaining counterparty confirmation for major grant income.

### Audit conclusion

Our work has provided the assurance we sought and has not highlighted any material issues to bring to your attention.

## Pension Estimates (IAS 19)

### Description of the risk

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 uses estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.

### How we addressed this risk

We discussed with management the significant changes to the pension estimates prior to the preparation of the financial statements. In addition to our standard programme of work in this area, we:

- evaluated the management controls you have in place to assess the reasonableness of the figures provided by the Actuary; and
- considered the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned by the National Audit Office.

### Audit conclusion

Our work has provided the assurance we sought and has not highlighted any material issues to bring to your attention.

## Property, plant and equipment

### Description of the area of management judgement

Valuations of these assets, in particular of land and buildings, require work from an expert valuer. Valuations of buildings must reflect both the condition of the building but also the valuation basis for that class of building as required by the CIPFA 'code'.

### **How we addressed this area of management judgement**

We:

- examined the professional qualifications of your valuer;
- challenged and substantiated the assumptions and the appropriateness of the date of the valuation used by your valuer in completing the valuations;
- ensured that valuations and impairments had been completed on the correct basis for each item and that movements were in line with expectation; and
- assessed whether the report produced by the valuer had been correctly reflected in the accounts.

### **Audit conclusion**

Our work has provided the assurance we sought and has not highlighted any material issues to bring to your attention.

## **Annual Governance Statement**

The aim of the Annual Governance Statement is to give an overview of the governance arrangements in place during the year as well as any potential significant governance issues arising.

We reviewed the Annual Governance Statement to see whether it complied with relevant guidance and whether it was misleading or inconsistent with what we know about the Council. We found no areas of concern to report in this context.

## **Weaknesses in internal control**

We have not identified any significant deficiencies as a result of our work this year. A small number of minor control issues have been reported to Management.

### **IT audit review**

As part of the audit for the year ended 31 March 2016 the objective of our IT audit work was to provide an assessment on the design, implementation and operating effectiveness of the key IT general controls over applications supporting the Council's financial statements.

The IT general controls work covered security, change management, and IT operations for the key systems materially relevant to the financial statements.

We concluded that reliance can be placed on the IT general controls operating over the systems reviewed. No significant issues were identified that could have an impact on the financial statements.

We did, however, raise three recommendations which have been agreed with officers and action plans are being produced in order to address the identified control issues.

## **Assurance to the National Audit Office**

We issued our certificate, closing this year's audit, on 20 October 2016 on completion of our work on your Whole of Government Accounts return. There were no matters to report.

# 03 Economy, efficiency and effectiveness

We are required to conclude whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources by considering one overall criterion which is made up of three sub-criteria.

The overall criterion set out by the National Audit Office is:

‘In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.’

The three sub-criteria are set out below.

Sub-criteria
Informed decision making
Sustainable resource deployment
Working with partners and other third parties

As part of our work, we also:

- reviewed the annual governance statement;
- reviewed the work of other relevant regulatory bodies or inspectorates to the extent the results of the work have an impact on our responsibilities; and
- carried out risk-based work we determined appropriate.

In the Audit Strategy Memorandum we identified a significant risk relevant to the VFM conclusion:

VFM significant risk
<p><b>Description of the risk</b></p> <p>The Council continues to face financial pressures from reduced funding, increased demand and changing responsibilities. The Council is responding to the challenges by a programme of efficiencies, service reviews and developing new ways to manage demand and deliver services. The risk is that the measures taken by the Council are not effective, leading to a lack of financial resilience</p>
<p><b>How we addressed this risk</b></p> <p>We reviewed:</p> <ul style="list-style-type: none"><li>• monitoring and action plans for a sample of savings included in the 2015/16 budget;</li><li>• the Medium-Term Financial Strategy (MTFS);</li><li>• budget monitoring reports and other finance updates;</li><li>• the progress made in identifying further savings required in 2016/17 and 2017/18; and</li><li>• the progress of the Council’s Change (formerly Transformation) Programme.</li></ul>

## Specific work on VFM significant risk

### Achievement of 2015/16 savings

As highlighted above, the Council identified required savings of £19.1 million as part of the 2015/16 budget setting process.

The amounts identified in the 2015/16 savings plans were deducted from the base budget allocations. If any service identified that it could not meet any of the savings identified then it was required to make alternative savings from other budgets within the service.

The Council monitored the savings plans using a risk assessment methodology and separate general ledger codes which allowed officers to keep track of delivery as part of the Council's monthly budget monitoring process. The latest position and any residual actions are escalated through the Strategy Group.

Overall at the end of 2015/16, the savings achieved were £16.8m which is a shortfall of £2.3m, meaning that 88% of the planned savings were achieved. Services made other savings to result in overall delivery of a £771,000 underspend.

We selected a sample of the 2015/16 savings plans and assessed delivery against the target level of savings. In the majority of cases the plans achieved the savings required however in one case we identified a scheme that did not deliver the saving required due to a delay in the implementation of new arrangements. In this case, the delay was reported to the Strategy Group and alternative arrangements were made in-year to ensure that the service met its overall budget target.

### Arrangements for achievement of 2016/17 savings target

The 2016/17 budget was presented to Council on 25 February 2016. The base budget was £198.9m and included a savings requirement of £18.8m. The budget was balanced without recourse to the General Reserve thus preserving reserve levels for subsequent years. However a total of £4.4m from reserves was earmarked to assist in service transformation and ensure Council priorities can be delivered whilst bringing down the cost of service delivery.

A summary of the budgeted 2016/17 savings is outlined below, split between each of the Council themes:

Budget Saving Proposals Theme Summary	Budget Saving 2016/17 £'000
Environment	(1,620)
Economic Growth	(832)
Communities & Volunteers	(643)
Adult Services	(9,192)
Governance & Resources	(2,382)
Public Health	(1,445)
Children and Young People	(2,682)
TOTAL	(18,796)

Each of the above theme summaries are made up of a number of detailed savings plans and we selected a sample to test in detail. We challenged management as to whether the savings were realisable in 2016/17.

The same detailed monitoring arrangements for the savings plans remain in place for 2016/17. Based on our review of the arrangements in place and management's responses to our challenge on the deliverability of a sample of savings plans, we have no recommendations to make in this area.

## **2017/18 savings target**

The process of working with Directorates to identify savings for the 2017/18 savings, currently identified in the MTFS, as £22.146m, has begun. This process will be managed through the Change Programme Board which meets weekly.

When a list of savings has been identified, due by Autumn 2016, it will then be challenged by both officers and members before being subject to a public consultation exercise which is due to begin in November 2016. A detailed savings plan will be produced and challenged as part of the 2017/18 budget process.

### **Review of the 2017-2022 Medium Term Financial Strategy (MTFS)**

We reviewed the Council's latest MTFS, which was presented to Cabinet on 12 July 2016, and considered the robustness of budget estimates and significant assumptions made.

The MTFS is based on a financial forecast over a rolling 5 year timeframe from 2017/18 to 2021/22 and is designed to help ensure resources are aligned to the outcomes in the Council Plan 2015-2020. The MTFS sets the financial context for the Council's resource allocation process and budget setting.

Over the 5 year period the Council faces a funding gap that is currently estimated at £92.3m. The size of this shortfall represents a significant challenge to the Council's effective financial planning and medium term financial sustainability.

The total savings required over a 5 year period is split as follows

- 2017-18 - £22.1m
- 2018-19 - £35.8m
- 2019-20 - £13.9m
- 2020-21 - £8.3m, and
- 2021-22 - £12.1m.

The Council has considered the assumptions relating to government funding over this period where possible and calculated its funding gap on this basis. There is a high level of uncertainty in some of the assumptions made. In particular, the Council will need to keep under review any impact of the recent EU referendum result and change of Prime Minister, Chancellor and other ministers on national policy on local government funding and devolution.

## **Progress of the Council's Change Programme**

On 9 February 2016, the Cabinet agreed to a major programme of change to guide budget decisions and the shape of the Council in the future.

The Change Programme (formerly Transformation Programme) is intended to deliver the fundamental changes required in the way the Council provides its services and works with partners in order to meet its aspirations with reduced funding. It is therefore of critical importance to both the Council's financial sustainability and its ability to achieve the desired outcomes set out in the Council Plan.

The Council has introduced 4 key workstreams to deliver the Change Programme. These are –

- People
- Place
- Trading
- Ways of working.

The workstreams, which are led by senior council officers, cover 30 projects designed to look at all aspects of the Council's business.

The Change Programme Board oversees delivery of the programme and comprises members of the Senior Leadership Team. In addition, Cabinet receive Quarterly Progress reports, the latest report being presented on 11 October 2016. The latest progress reports show that the Programme is at an early stage and will require sustained management focus to meet its objectives.

### **Conclusion**

Having completed our assessment, we concluded that the Council had proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources and issued an unqualified value for money conclusion on 22 September 2016.

# 04 Future challenges

The main financial challenge for the Council, along with other local authorities, is the expected continued reduction in central government funding and increased reliance on locally-raised revenue.

The Council's recent track record has demonstrated its ability to maintain focus on its priorities for the local community whilst managing significant reductions in spending. Successive years of spending reductions have reduced the scope for further efficiency savings, and the Council has recognised in its Change Programme that this requires it to fundamentally rethink its role and ways of working.

Further challenge to the Council's strategy and business model comes from the planned full localisation of business rates, the current position on devolution in the North East, and any local impact from the UK vote to leave the EU. We will take these future challenges into account when planning our audit work in 2016/17 and beyond.

# 05 Fees and closing remarks

Our Audit Strategy Memorandum presented to the Audit and Standards Committee on 7 March 2016 set out our proposed fees for the 2015/16.

The fees applicable to our work in 2015/16 are summarised below and are in line with the scale fees set by Public Sector Audit Appointments Ltd (PSAA).

Element of work	2014/15 Final Fee	2015/16 As previously reported	2015/16 Final Fee
Code audit work	£173,730	£130,298	£130,298
Certification work	£16,540	£10,615	£10,615*
<b>Total</b>	<b>£190,270</b>	<b>£140,913</b>	<b>£140,913</b>

\* The fee outlined above in relation to certification work is an estimate as we are yet to complete our work on certifying the Council's Housing Benefit claim. We will confirm the final fee charged for certification work when we issue our Certification Report.

In addition to the above, we have been requested by officers to carry out audit procedures on other non PSAA grant claims and returns. The non- audit work agreed to date is:

- certification of a Teacher's Pensions return; and
- certification of the Pooling of Housing Capital Receipts return.

We have discussed and agreed this letter with officers and will present it to the Audit and Standards Committee on 30 January 2017. It will also be communicated to the Accounts Committee (those charged with governance).

During the audit year we have continued to support the Council in other ways, including attendance at Audit and Standards Committees where we inform the Committee about progress on the audit, report our key findings and update it about developments in the sector and the wider environment.

Further detailed findings, conclusions and recommendations in the areas covered by the audit are included in the reports issued to the Council during the year, which are summarised below.

Report	Date issued
2015/16 Audit Fee Letter	April 2015
Audit Strategy Memorandum	February 2016
Progress reports to Audit Committee	To each Audit Committee meeting
Audit Completion report	July 2016
Auditor's Report (opinion, VfM conclusion and certificate)	September 2016
Annual Audit Letter	October 2016

The Council has continued to take a positive and constructive approach to our audit and I wish to thank the Audit and Standards Committee for their continued support and co-operation throughout the year. We would also like to record our appreciation for the assistance and co-operation provided to us during our audit by finance staff.

We are committed to supporting the Council to move forward with clarity of purpose and strong governance and accountability arrangements. We will meet with the officers to identify learning from the 2015/16 audit and will continue to share our insights from other client and relevant knowledge from the wider public and private sector.

**Gareth Davies**  
**Partner**  
**October 2016**

# Appendix A – Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assumed that users:

- have a reasonable knowledge of business, economic activities and accounts
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We considered materiality whilst planning and performing our audit.

Whilst planning, we made judgements about the size of misstatements which we considered to be material and which provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

In 2015/16 we set materiality at the planning stage at £11.478 million (2 per cent of gross revenue expenditure) with a clearly trivial threshold of £344k below which identified errors will not usually be reported. We set lower materiality levels for the accounting entries we consider to be more sensitive, for example, senior officer's remuneration, as we considered these items to be of specific interest to users of the accounts sufficient to warrant audit procedures which would not otherwise be applied based on the materiality level for the audit as a whole. The materiality determined at the planning stage did not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, would be considered as immaterial.

We revised materiality for the financial statements as our audit progressed. Our closing assessment of materiality in 2015/16, based upon the final version of the financial statements, was £11.556 million with a clearly trivial threshold of £346k below which identified errors were not reported.

We discussed with management any significant misstatements or anomalies that we identified during the course of the audit and we reported in our Audit Completion Report all unadjusted misstatements we identified other than those which were clearly trivial, and obtained written representation that explained why these remain unadjusted.

Should you require any further information, please do not hesitate to contact:

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This Annual Audit Letter is prepared in the context of the ‘Statement of responsibilities of auditors and audited bodies 2015-16’ issued by Public Sector Audit Appointments Ltd. It is addressed to the Audit and Standards Committee on behalf of those charged with governance of Gateshead Council. We, as appointed auditor, take no responsibility to any third party.

Mazars LLP is the UK firm of Mazars, an international advisory and accountancy organisation, and is a limited liability partnership registered in England with registered number OC308299. A list of partners’ names is available for inspection at the firm’s registered office, Tower Bridge House, St Katharine’s Way, London E1W 1DD.

We are registered to carry on audit work in the UK by the Institute of Chartered Accountants in England and Wales. Details about our audit registration can be viewed at [www.auditregister.org.uk](http://www.auditregister.org.uk) under reference number C001139861.