ESSEX COUNTY COUNCIL AND ESSEX PENSION FUND

Annual Audit Letter

Year ended 31 March 2019

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EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

This Annual Audit Letter summarises the key issues arising from the work that we have carried out in respect of the year ended 31 March 2019.

It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public.

Responsibilities of auditors and the Council

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's (NAO's) Code of Audit Practice (the Code). Under the Code, we are required to report:

- Our opinion on the Council's and Pension Fund's financial statements; and
- Whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

BDO LLP

29 August 2019

Audit conclusions

Audit area	Conclusion
Financial statements - Council	Unmodified opinion
Financial statements – Pension Fund	Unmodified opinion
Use of resources	Unmodified conclusion
Audit certificate	We are unable to issue our audit certificate until we have completed our review of the Whole of Government Accounts return and issued our opinion on the consistency of the return with the audited financial statements.

We issued our audit opinion on the Council's and Pension Fund's financial statements and use of resources conclusion on 31 July 2019.

We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the audit.

FINANCIAL STATEMENTS

Audit opinion on the financial statements

We issued an unmodified audit opinion on the financial statements. This means that we consider that the financial statements:

- Give a true and fair view of the financial position and its income and expenditure for the year; and
- Have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting 2018/19.

Final materiality

Materiality for the Council's financial statements as a whole was calculated at £30.9 million based on a benchmark of 1.5% of gross expenditure.

Materiality for the Pension Fund financial statements was calculated at £70 million based on 1% of net assets. Specific materiality (at a lower level) was set for the fund account balances at £12 million and this was based on 5% of total contributions receivable.

Material misstatements

We did not identify any material misstatements.

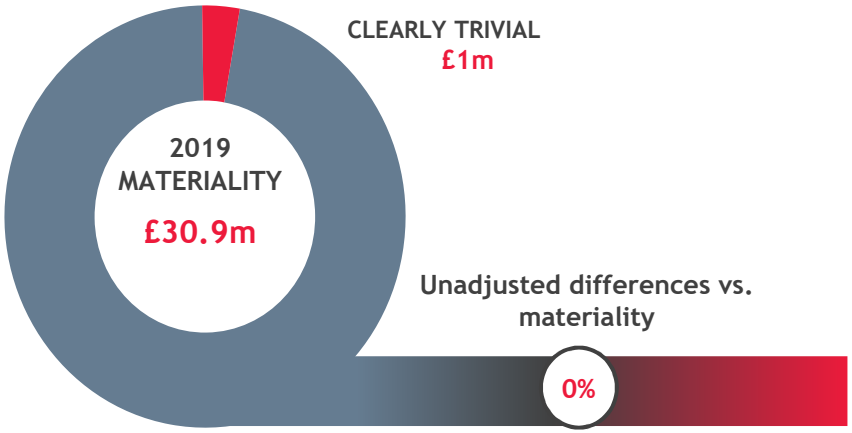
Unadjusted audit differences

We did not identify any misstatements above a trivial level that were not adjusted for in the Council's financial statements.

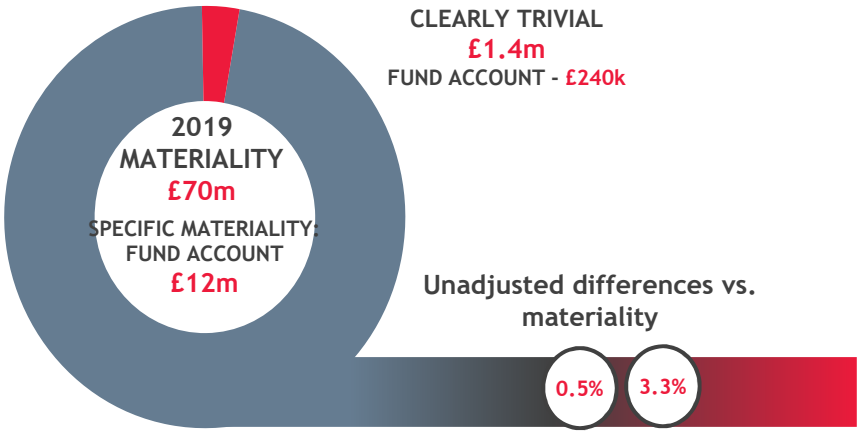
We identified one audit adjustment in the Pension Fund financial statements that, if posted, would increase the 'Net increase in the assets available for benefits during the year' in the Fund Account and increase 'Net assets of the scheme available to fund benefits' in the Net Asset Statement by £394,000.

The above audit adjustment is below the overall triviality applied to the Net Assets Statement, but above the specific triviality applied to the Fund Account.

COUNCIL FINAL MATERIALITY



PENSION FUND FINAL MATERIALITY



FINANCIAL STATEMENTS

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

Risk description	How the risk was addressed by our audit	Results
Management override of controls (Council and Pension Fund)	We carried out the following planned audit procedures: • Determined key risk characteristics to filter the population of journals, using our IT team to assist with the journal extraction; • Using our data analytics software, reviewed and verified large and unusual journal entries made in the year and agreed the journals to supporting documentation; • Reviewed estimates and judgements applied by management in the financial statements to assess their appropriateness and the existence of any systematic bias. • Reviewed unadjusted audit differences for indications of bias or deliberate misstatement.	No issues were identified by our audit of journals and accounting estimates for management override of controls or management bias.
Revenue and expenditure recognition (Council only)	We carried out the following planned audit procedures: • Tested a sample of grants recognised as revenue to documentation from grant paying bodies and check whether recognition criteria had been met; and • Tested a sample of expenditure either side of year end, to confirm that expenditure had been recorded in the correct period and that all expenditure that should have been recorded at year end had been.	No issues were identified by our audit of grants recognised as revenue or expenditure either side of the year end.

FINANCIAL STATEMENTS

Risk description	How the risk was addressed by our audit	Results
Pension liability valuation (Council and Pension Fund)	We carried out the following planned audit procedures: • Agreed the disclosures to the information provided by the pension fund actuary; • Reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data; • Reviewed the controls for providing accurate membership data to the actuary; • Checked whether any significant changes in membership data have been communicated to the actuary; and • Discussed with the actuary how the impact of the GMP gender discrimination and McCloud age discrimination judgements have been taken into account in the liability assumptions at 31 March 2019.	We were able to agree disclosures to information provided by the actuary and are satisfied that the assumptions used in the calculation of the liability were not unreasonable or outside of the expected ranges. Recent legal cases regarding transitional protection for members of certain public sector pension schemes where the terms of the benefit provided by the scheme have changed determined that these protections were age discriminatory. No allowance was made for these judgements in the information provided to the Council by the actuary for the purposes of preparing its Statement of Accounts due to the uncertainty surrounding the impact on the Local Government Pension Scheme (LGPS). Following publication of the Council's and Pension Fund's unaudited 2018/19 Statement of Accounts, the government's request for an appeal relating to one of these cases was refused by the Supreme Court. While the impact on the LGPS is unknown, there is sufficient information to calculate a reasonable estimate of the liability. The Council requested the actuary to prepare updated information recognising the impact of the judgements, resulting in an increase in both past service cost and the net pension liability of £22.4 million for the Council and £79.3 million for the Pension Fund. The accounts were updated to reflect the revised information provided by the actuary.

FINANCIAL STATEMENTS

Risk description	How the risk was addressed by our audit	Results
Valuation of land, buildings and investment properties (Council only)	We carried out the following planned audit procedures: • Reviewed the instructions provided to the external valuer and reviewed the valuer's skills and expertise in order to determine if we could rely on the management expert; • Confirmed that the basis of valuation for assets valued in year is appropriate based on their usage; • Reviewed accuracy and completeness of asset information provided to the valuer such as rental agreements and sizes; • Reviewed assumptions used by the valuer and movements against relevant indices for similar classes of assets and followed up valuation movements that appeared unusual; and • Reviewed all properties not subject to in-year valuation against changes in market conditions to assess the impact on the value of the Council's portfolio	No issues were identified by our audit of the valuation of land, buildings and investment properties.

FINANCIAL STATEMENTS

Risk description	How the risk was addressed by our audit	Results
Valuation of investments (unquoted and direct property investments) (Pension Fund only)	We carried out the following planned audit procedures: • Obtained direct confirmation of investment valuations from the fund managers and request copies of the audited financial statements (and member allocations) from the fund; • Reviewed the valuation completed by the fund manager and any significant assumptions made in the valuation; • Where the financial statement date supporting the valuation was not coterminous with the pension fund's year end, we confirmed that appropriate adjustments were made to the valuations in respect of additional contributions and distributions with the funds; and • Ensured investments were correctly valued in accordance with the relevant accounting policies.	The direct confirmations obtained from fund managers identified that the valuation of private equity and property investments were overstated by non material amounts of £8.9m and £1.4m respectively. The investment valuations for timber and infrastructure were understated by £6.6m and £3.8m respectively. These variances are due to the fact that some investment reports used during the preparation of financial statements were not coterminous with the year-end date and therefore estimates were made. The net difference of the above misstatements along with other non material differences identified amounted to £0.4m. For investments in private equity, illiquid debt, infrastructure and timber, we obtained audited financial statements of the underlying investee funds, and valuations were recalculated by adjusting the additional contributions and distributions where relevant. This identified that the valuation of private equity were overstated by an extrapolated value of £6.5m and investment in infrastructure were overstated by £1.8m. These amounts were offset by the understatement of valuations in investment in timber and illiquid debts by £6.5m and £1.6m respectively, giving a net difference of £0.2m. Therefore, we are satisfied that the valuation of unquoted investments in the Net Assets Statements is reasonable.

USE OF RESOURCES

Audit conclusion on use of resources

We issued an unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. This means that we consider that in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We set out below the risk that had the greatest effect on our audit strategy.

Risk description	How the risk was addressed by our audit	Results
Sustainable finances	We carried out the following planned audit procedures: • Reviewed the financial outturn for 2018/19 and progress against the 2019/20 budget, as a starting point for assessing the effectiveness of financial management arrangements; • Considered the reasonableness of the MTRS assumptions, including investment costs associated with major savings schemes and capital projects; • Reviewed arrangements to identify savings, including any relevant Internal Audit work, evidence underpinning a sample of identified savings schemes, and progress towards identifying further savings to balance the budget in the medium term; and • Carried out benchmarking to compare the Council's financial performance against other county councils, taking account of relevant contextual information, in informing our assessment of the strength of the Council's financial management arrangements.	We are satisfied the Council has adequate arrangements for budget monitoring and taking mitigating actions to eliminate the impact of any overspends and undeliverable savings. As a result it has retained its track record of delivering underspends in the General Fund and is on track to deliver its required savings in 2019/20. The Medium Term Resources Strategy (MTRS) reflects known savings and cost pressures and the key assumptions are reasonable. The MTRS and the Council's Finance Outlook towards the end of 2018/19 indicated cumulative budget gaps of £148 million by the end of 2023/24. Based on this position, if no further savings are made in 2020/21 to 2023/24, above those already identified and assumed in the MTRS, the Council's general fund balance, reserve for future capital funding and other unrestricted earmarked reserves would be fully depleted. However, the Council has a comprehensive business planning process in place and significant work has been done to identify further savings of £116 million over the four year period to 2023/24, with £64.2 million identified for 2020/21. This compares to a average of £59 million in 2018/19 and 2019/20. This has reduced the budget gap to a cumulative £54.3 million by 2023/24, of which £27.3 million relates to 2020/21. The Council has sufficient unrestricted earmarked reserves to cover this shortfall, if necessary. Achieving the identified savings and closing the remaining budget gaps will be challenging and will continue to require strong leadership and action by the Council, particularly if the Council wants to maintain its general fund and unrestricted earmarked reserves balances at current levels over the medium term. However, we are satisfied that the Council has adequate arrangements in place to remain financially sustainable in the medium term.

FEES AND REPORTS ISSUED

Fees summary

	2018/19 Final £	2018/19 Planned £
Audit fee – PSAA scale fee		
• Council	126,265	126,265
• Pension Fund	24,075	24,075
Other fees under PSAA arrangements		
Pension Fund - IAS 19 Assurance letters	5,500	5,500
Non-audit assurance services:		
Fees for reporting on government grants:		
• Teachers' pensions return	TBC	TBC
Total fees	TBC	TBC

Communication

Reports	Date	To whom
Audit plan – Council	25 March 2019	Audit, Governance and Standards Committee
Audit plan – Pension Fund	25 March 2019	Audit, Governance and Standards Committee
Audit completion report – Council	29 July 2019	Audit, Governance and Standards Committee
Audit completion report – Pension Fund	29 July 2019	Audit, Governance and Standards Committee

FOR MORE INFORMATION:

David Eagles, Partner

t: 01473 320728
e: david.eagles@bdo.co.uk

The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the organisation and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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