



# ESSEX COUNTY COUNCIL AND ESSEX PENSION FUND

Annual Audit Letter

Year ended 31 March 2020

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# EXECUTIVE SUMMARY

## Purpose of the Annual Audit Letter

This Annual Audit Letter summarises the key matters arising from the work that we have carried out in respect of the year ended 31 March 2020.

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.

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.

**BDO LLP**

5 March 2021

## 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 financial statements and use of resources conclusion on 30 November 2020

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# 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 2019/20.

## Final materiality

Materiality for the Council's financial statements was calculated at £37.3 million based on a benchmark of 1.75% of gross expenditure.

Materiality for the Pension Fund financial statements was calculated at £66 million based on 1% of net assets. Specific materiality (at a lower level) was set for the fund account balances (excluding changes in the market value of investments) at £25 million and this was based on 7.5% of gross expenses in the Fund Account.

## Material audit differences

Our audit identified the following material differences in the Council's financial statements:

- Bank accounts in an overdraft position at both 31 March 2020 and 31 March 2019 were shown net against cash and cash equivalents on the face of the balance sheet. These bank accounts should have been shown gross as current liabilities.

- Cash outflows associated with revenue expenditure funded from capital under statute (REFCUS) were classified as investing activities in both 2018/19 and 2019/20. These cash flows should have been shown as operating activities.
- Cash inflows and outflows associated with purchases of and proceeds from investments were shown net in Note 28 Cash flows from operating, investing and financing activities for both 2018/19 and 2019/20. These cash flows should have been shown gross.

Management amended the financial statements for these audit differences. There was no impact on the total value of the cash balances held by the Council.

No material audit differences were identified in the Pension Fund's financial statements

## Unadjusted audit differences

We identified two audit adjustments in the Council's financial statements that, if posted, would reduce the deficit on the provision of services for the year by £2.195 million.

We identified two audit adjustments in the Pension Fund's financial statements that, if posted, would increase the 'Net decrease in the assets available for benefits during the year' in the Fund Account and decrease 'Net assets of the scheme available to fund benefits' in the Net Asset Statement by £19.123 million.

No adjustment was made for the above differences as they were considered to be immaterial in the context of the financial statements as a whole.

# 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
<p>Management override of controls (Council and Pension Fund)</p>	<p>We carried out the following planned audit procedures:</p> <ul style="list-style-type: none"> <li>• Reviewed and verified journal entries made in the year, agreeing the journals to supporting documentation. We determined key risk characteristics to filter the population of journals.</li> <li>• Reviewed estimates and judgements applied by management in the financial statements to assess their appropriateness and the existence of any systematic bias; and</li> <li>• Reviewed unadjusted audit differences for indications of bias or deliberate misstatement.</li> </ul>	<p>No issues were identified by our audit of journals and accounting estimates for management override of controls or management bias.</p>
<p>Revenue and expenditure recognition (Council only)</p>	<p>We carried out the following planned audit procedures:</p> <ul style="list-style-type: none"> <li>• Tested a sample of grants recognised as revenue to documentation from grant paying bodies and check whether recognition criteria had been met; and</li> <li>• 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.</li> </ul>	<p>No issues were identified by our audit of revenue and expenditure recognition.</p>

# FINANCIAL STATEMENTS

Risk description	How the risk was addressed by our audit	Results
Valuation of pension liability  (Council and Pension Fund)	<p>We carried out the following planned audit procedures:</p> <ul style="list-style-type: none"> <li>• Agreed the disclosures to the information provided by the pension fund actuary;</li> <li>• Reviewed the competence of the management expert (actuary);</li> <li>• Reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data;</li> <li>• Reviewed the controls in place for providing accurate membership data to the actuary;</li> <li>• Tested a sample of membership and cash flow data sent to the actuary for existence and accuracy, and reconciled the membership data sent to the actuary to the membership administration system for completeness;</li> <li>• Checked that any significant changes in membership data were communicated to the actuary.</li> </ul>	<p>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 within the expected ranges.</p> <p>In respect of cash flow data provided to the actuary for the triennial valuation, we identified no issues. However, testing of the cash flow data provided to the actuary for the roll forward valuation at 31 March 2020 identified some differences between the estimated contributions (based on month 10 actual amounts plus estimated amounts for the final two months of the year) and the actual amounts for the year. We did not consider these to be significant differences that would materially impact on the liability valuation.</p> <p>Following the ruling on age discrimination on the McCloud case and gender discrimination on a Lloyds case in the prior year, the actuary made an allowance at the last accounting date. This was therefore included in the opening liability for this year and the actuary confirmed that this allowance was re-measured 31 March 2020. The approach adopted by the actuary is considered to be reasonable.</p>

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# FINANCIAL STATEMENTS

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Risk description	How the risk was addressed by our audit	Results
Valuation of land, buildings and investment properties  (Council only)	<p>We carried out the following planned audit procedures:</p> <ul style="list-style-type: none"><li>• Reviewed the instructions provided to the valuer and the valuer’s skills and expertise in order to determine if we can rely on the management expert;</li><li>• Confirmed that the basis of valuation for assets valued in year was appropriate based on their usage;</li><li>• Reviewed accuracy and completeness of information provided to the valuer, such as rental agreements and sizes;</li><li>• Reviewed assumptions used by the valuer and movements against relevant indices for similar classes of assets;</li><li>• Followed up valuation movements that appear unusual; and</li><li>• Confirmed that assets not specifically valued in the year were assessed to ensure their reported values remained materially correct.</li></ul>	<p>We found that the indexation applied to specialised assets not subject to full revaluation in 2019/20 was outside of our expectations. The Council performed further work (which we reviewed as part of our audit procedures) and concluded that the value of land and buildings recognised in the balance sheet was understated. The maximum value of the error arising from this issue was an £18.250 million understatement of the value of land and buildings.</p> <p>No adjustment was made to the financial statements for this matter as neither the Council nor BDO considered it to be material.</p> <p>This error had no impact on the Council’s general fund or the resources available to fund services.</p> <p>No other issues were identified by our audit.</p>

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# FINANCIAL STATEMENTS

Risk description	How the risk was addressed by our audit	Results
<p>Valuation of investments (unquoted and direct property investments)</p> <p>(Pension Fund only)</p>	<p>We carried out the following planned audit procedures:</p> <ul style="list-style-type: none"> <li>• Obtained direct confirmation of investment valuations from the fund managers and requested copies of the audited financial statements (and member allocations) from the fund;</li> <li>• Reviewed the valuation completed by the fund manager and any significant assumptions made in the valuation;</li> <li>• For property valuations, we agreed input data used by the valuer such as agreeing rental information to the underlying rental agreements, and reviewed the rental yields against the comparable data and indices for reasonableness;</li> <li>• Where the financial statement date supporting the valuation is not conterminous with the pension fund's year end, we confirmed that appropriate adjustments have been made to the valuations in respect of additional contributions and distributions with the funds; and</li> <li>• Checked whether the investments have been correctly valued in accordance with the relevant accounting policies</li> </ul>	<p>Our review of direct confirmations obtained from fund managers found that the valuation of private equity was overstated by a non material amount of £3.621 million, with a total overstatement of investments of £5.239 million across all categories of investments.</p> <p>We also reviewed reasonableness of the adjustments made to private equity valuations to account for the impact of Covid-19. Our procedures identified that the reductions applied to reflect the impact of Covid-19 were not consistent with our expectations resulting in the value of private equity investments being overstated by £13.884 million.</p> <p>No adjustment was made to the financial statements for this matter as neither the Pension Fund nor BDO considered it to be material.</p>

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# 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 risks that had the greatest effect on our audit strategy:

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Risk description	How the risk was addressed by our audit	Results
The Council will need to deliver significant savings to maintain financial sustainability in the medium term and there is a risk that some required savings may not be delivered.	<p>We carried out the following planned audit procedures:</p> <ul style="list-style-type: none"><li>Reviewed the financial outturn for 2019/20 and progress against the 2020/21 budget, as a starting point for assessing the effectiveness of financial management arrangements;</li><li>Considered the reasonableness of the medium term resourcing strategy assumptions, including investment costs associated with major savings schemes and capital projects; and</li><li>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.</li></ul>	<p>The Council has adequate arrangements for business planning, budget setting, monitoring and taking mitigating actions to eliminate the impact of any overspends and undeliverable savings. It has retained its track record of delivering underspends in the General Fund in 2019/20 and is expected to deliver the majority of its savings for 2020/21.</p> <p>The Council's medium term resourcing strategy reflects known savings and cost pressures and the key assumptions are reasonable, although there is significant uncertainty in future funding levels. The strategy indicated unidentified savings gaps of £71 million by the end of 2023/24. This gap is expected to increase as a result of council tax and business rate funding decreases during the Covid-19 pandemic.</p> <p>If no further savings are made in 2021/22 to 2024/25 above those already identified, we understand that the Council would have sufficient reserves to cover this shortfall in the medium term, if necessary, and maintain its general fund balance at 6% of the net budget.</p> <p>The financial position remains challenging and the Council will not have sufficient reserves to cover its cumulative savings requirement by the end of the 2024/25 period if it does not continue to demonstrate strong leadership and action in achieving the planned savings. However, we are satisfied that the Council has adequate arrangements in place to remain financially sustainable in the medium term.</p>

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# REPORTS ISSUED AND FEES

## Fees summary

	2019/20 Final £	2019/20 Planned £	2018/19 Final £
<b>Council</b>			
Code audit fee	(1) 137,620	(1) 137,620	126,265
Non-audit assurance services:			
Fees for reporting on government grants:			
• Teachers' pensions return	12,000	12,000	12,000
<b>Total fees - Council</b>	<b>149,620</b>	<b>149,620</b>	<b>138,265</b>
<b>Pension Fund</b>			
Code audit fee	(2) 28,000	(2) 28,000	24,075
Additional fee for IAS19 assurance requests from scheduled bodies	(3) 12,250	(3) 11,500	5,500
<b>Total fees - Pension Fund</b>	<b>40,250</b>	<b>39,500</b>	<b>29,575</b>

## Communication

Reports	Date	To whom
Audit plan	6 March 2020	Audit, Governance and Standards Committee
Audit progress report	28 September 2020 16 November 2020	Audit, Governance and Standards Committee
Audit completion report	30 November 2020	Audit, Governance and Standards Committee

(1) The increase in the Council's code audit fee reflects the increased expectations relating to the work necessary to audit valuations of non-current assets, pension liabilities and group accounts and risk related work in respect of the disposal of Essex Education Services and termination of the Tending PPP.

(2) The increase in the Pension Fund code audit fee reflects the increased expectations relating to the work necessary to audit valuations of pension investments (particularly unquoted and direct property investments) and the fund liability applied nationally.

(3) The increased Pension Fund assurance requests fee represents the work necessary in 2019/20 to audit the data cleansing work undertaken by the actuary in connection with the triennial valuation of the pension fund liability (and asset allocations). This element is only relevant in the year of triennial valuation and will not recur until the next triennial valuation (i.e. 2022/23). The increase in actual fee from the planned fee is due to a request received from an additional body.



FOR MORE INFORMATION:

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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 company and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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