

Gosport Borough Council

Annual Audit Letter for the year
ended 31 March 2019

August 2019

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y'.

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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.psa.co.uk).

This 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 April 2018)' issued by PSAA set 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 and Terms of Appointment. 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 Gosport Borough Council (the Council) following completion of our audit procedures for the year ended 31 March 2019. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ▶ Financial statements	Unqualified - the financial statements give a true and fair view of the financial position of the Council as at 31 March 2019 and of its expenditure and income for the year then ended
▶ 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 Annual Governance Statement	The Annual 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 £500mn. 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 audit.	Our Audit Results Report was issued on 18 July 2019.
Issued a certificate that we have completed the audit 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 31 July 2019.

We would like to take this opportunity to thank the Council 's staff for their assistance during the course of our work.

Kevin Suter

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 2018/19 Audit Results Report to the 24 July 2019 Policy and Organisation Board, 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.

Responsibilities of the Appointed Auditor

Our 2018/19 audit work has been undertaken in accordance with the Audit Plan that we issued on 28 January 2019 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2018/19 financial statements; 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 (AGS). In the AGS, 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's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2019.

Our detailed findings were reported to the 24 July 2019 Policy and Organisation Board.

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

Significant Risk	Conclusion
<p>Misstatements due to fraud or error</p> <p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>As identified in ISA (UK) 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.</p>	<ul style="list-style-type: none">• We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements.• We reviewed accounting estimates for evidence of management bias.• We evaluated the business rationale for any significant unusual transactions. <p>We did not identify any material weaknesses in controls or evidence of material management override.</p> <p>We did not identify any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.</p>

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
<p>Risk of fraud in revenue and expenditure recognition – inappropriate capitalisation of revenue expenditure</p> <p>Under ISA (UK) 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>We assessed that the risk is most likely to occur through the inappropriate capitalisation of revenue expenditure, leading to overstatement of Property, Plant and Equipment (PPE) in the Balance Sheet, and understatement of expenditure in the Comprehensive Income and Expenditure Statement.</p> <p>The value of PPE additions in 2018/19 was £4.9m.</p>	<ul style="list-style-type: none"> • We tested PPE additions using lowered testing thresholds, to ensure they were appropriately supported by documentary evidence, and that the expenditure incurred and capitalised was clearly capital in nature. • When performing journals testing, we challenged the basis for any significant journals transferring expenditure from non-capital codes to PPE additions or from revenue to capital codes on the general ledger at the end of the year. <p>We did not identify any instances of inappropriate capitalisation of revenue expenditure.</p>

Other areas of audit focus	Conclusion
<p>Valuation of Land and Buildings, and Investment Property</p> <p>The fair value of Property, Plant and Equipment (PPE) and Investment Property (IP) represent significant balances in the Authority's accounts and are 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>ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p> <p>The net book value of PPE at 31/03/2019 was £186.7m, and the value of IP was £6.5m.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> • The adequacy of the scope of the work performed by the Authority's expert valuers including their professional capabilities. • The reasonableness of the underlying assumptions used by the valuers. <p>We identified errors above our reporting threshold. The first was in the valuation of property, plant and equipment where the value of all the Council's car parks was incorrectly calculated. The second was an error in the valuation of investment property where an incorrect rent figure had been used in the valuation of a specific property. This is the third year in succession where we have identified errors in the calculation of PPE and investment property valuations; as a result, we would recommend that management undertake more extensive procedures to review the work of the valuer prior to incorporation of the valuations into the draft statement of accounts going forward.</p>

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other areas of audit focus	Conclusion
<p>Pension Liability Valuation</p> <p>The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p> <p>The net pension liability at 31/03/2019 was £37.5m.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> • The reasonableness of the underlying assumptions used by the Authority's expert – Aon Hewitt. • Ensuring the information supplied to the actuary in relation to Gosport Borough Council was complete and accurate. • Ensuring the accounting entries and disclosures made in the financial statements were consistent with the report from Aon Hewitt. <p>We did not identify any material issues with regard to the valuation of the pension liability. We identified two immaterial audit differences, which management chose not to adjust, as a result of reviewing the assumptions made by the actuary, and comparing against actual values for the year.</p>
<p>New Accounting Standards</p> <p>IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) applied from 1 April 2018.</p> <p>IFRS 9 changed:</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 instruments. <p>The key requirements of IFRS 15 cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The impact on local authority accounting is generally limited as large revenue streams like council tax, non domestic rates and government grants are outside the scope of IFRS 15.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> • Assessing the Authority's implementation arrangements and accounting for the new standards in 2018/19. <p>The Authority was able to demonstrate that implementation of IFRS 15 had no material impact on its financial reporting arrangements.</p> <p>For IFRS 9 we concluded that:</p> <ul style="list-style-type: none"> • Required changes to the classification and accounting for financial instruments were made correctly. • Any changes in impairments and provisions for financial assets were immaterial to the accounts. • Following some additions/minor amendments made as a result of our audit, CIPFA Code disclosure requirements were met.

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 to be £1.27m (2017/18: £1.29m), which is 2% of gross revenue expenditure reported in the accounts of £63.6 million. 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 Policy and Organisation Board that we would report to the Committee all audit differences in excess of £0.064m (2017/18: £0.064m)

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits: these areas were tested in full as part of our audit
- ▶ Related party transactions: these were tested in full as part of our audit

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

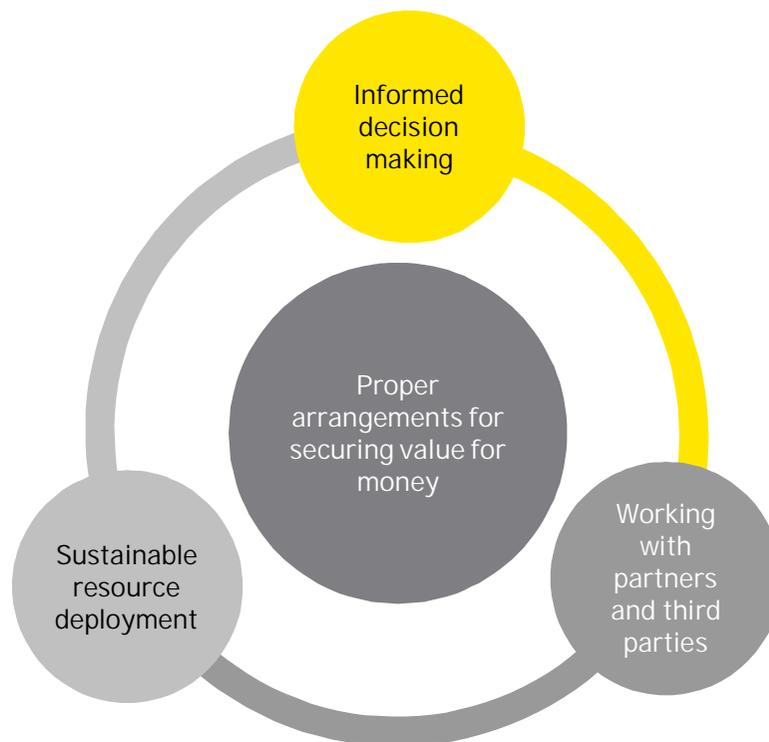


04 Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in 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 risks in relation to these arrangements. The table on the next page presents the findings of our work in response to the risk identified and any other significant weaknesses or issues to bring to your attention.

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 31 July 2019.

Value for Money (cont'd)

Significant Risk	Conclusion
<p>Provision of an effective internal audit function as a key component of a sound system of internal control</p> <p>An independent review against Public Sector Internal Audit Standards (PSIAS), undertaken in 2018/19, identified a number of issues with regard to the Council's internal audit service. Of the 49 relevant internal audit standards, 7 were found not to have been complied with, and 7 were found to have been partially complied with. The key findings related to the way in which the audit universe had been defined, and the process used to scope and properly risk assess the audit reviews included in the internal audit annual plan. Findings were also identified with regard to the quality assurance and improvement programme within internal audit, and the lack of an up to date audit manual.</p> <p>As these findings highlighted a number of areas in which the internal audit service was not compliant with expected standards, we sought to understand how these are being addressed by the Council to ensure future compliance.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> • Understanding the findings of the PSIAS review • Reviewing the Council's action plan to address the issues identified • Confirming the findings of the PSIAS review are appropriately reflected in the 2018/19 Annual Governance Statement (AGS) • Understanding any impact of the findings on the 2018/19 Head of Internal Audit Opinion • Reviewing the 2019/20 internal audit plan to confirm this is properly supported by an defined audit universe and risk assessment <p>The Council has put in place a comprehensive action plan to address the findings of the review and to ensure full compliance with PSIAS in future. A re-review against PSIAS is scheduled to take place in February 2020, which provides a deadline by which the action plan will need to be implemented.</p> <p>The 2018/19 AGS has appropriately identified the findings of the PSIAS review as a significant governance issue and confirms this will be addressed through the agreed action plan noted above.</p> <p>The Head of Internal Audit Opinion, issued by the acting Head of Internal Audit, provides Substantial Assurance on the effectiveness of the control framework and governance processes at Gosport Borough Council, based on the results of the internal audit work performed in the year; it is caveated with regard to the PSIAS findings, which is within expectations. We note that neither the PSIAS review nor the acting Head of Internal Audit has identified significant issues with the quality of the actual internal audit work carried out within the reviews as scoped.</p> <p>An audit universe has been defined for 2019/20, and an audit strategy drafted. A process of risk scoring and assessment has been used to underpin the internal audit plan for 2019/20.</p> <p>In our judgment, the Council has acted appropriately to address the findings of the PSIAS review. An action plan has been created to address the findings, and steps have already been taken to achieve compliance in a number of the key areas where issues were identified. The AGS reflects the issue, as does the Head of Internal Audit's opinion. Full compliance remains subject to completion of the remaining actions within the action plan, but we judge that sufficient appropriate arrangements have been put in place to make the required changes, and as such, our value for money conclusion for 2018/19 is unmodified.</p>



05 Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

The Council is below the specified audit threshold of £500m. Therefore, we were not required to 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 2018/19 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 Report to the Policy and Organisation Board on 24 July 2019. 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

As part of our work, 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 are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive audit approach and have therefore not tested the operation of controls.

Our audit did not identify any controls issues to bring to the attention of the Policy and Organisation Board.



06

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 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 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 2020/21 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 2020/21 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>
IASB Conceptual Framework	<p>The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>This introduces;</p> <ul style="list-style-type: none"> - new definitions of assets, liabilities, income and expenses - updates for the inclusion of the recognition process and criteria and new provisions on derecognition - enhanced guidance on accounting measurement bases - enhanced objectives for financial reporting and the qualitative aspects of financial information. <p>The conceptual frameworks is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards.</p> <p>However, an understanding of concepts and principles can be helpful to preparers of local authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.</p>	<p>It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements.</p> <p>However, Authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.</p>

A close-up photograph of a person's hand reaching into a filing cabinet to touch a folder. The cabinet is filled with numerous folders of various colors (yellow, blue, white) and sizes, each containing stacks of papers. The background is a textured, light-colored wall.

07 Audit Fees

Audit Fees

Our planned fee for 2018/19 is in line with the scale fee set by the PSAA and reported in our 18 July 2019 Annual Results Report. Our final fee remains subject to agreement with management and PSAA.

Description	Proposed Final Fee 2018/19 £	Planned Fee 2018/19 £	Scale Fee 2018/19 £	Final Fee 2017/18 £
Total Audit Fee – Code work	44,356*	40,844	40,844	53,044

* See below for explanation:

As noted in section 4, we identified one significant risk to our value for money conclusion, which we were required to review. This represented an increase in scope from 2017/18, when no significant risks were identified. As such, we are proposing an additional fee of £2,171 for this work.

Our work on the valuation of property, plant and equipment, and investment property, identified some non-material errors which required additional work to quantify, respond to and document. As such, we are proposing an additional fee of £959 for this work.

As we are no longer the reporting accountant for the Council's housing benefit subsidy claim, we needed to undertake work as part of the financial statements audit which we would previously have performed as part of certifying the housing benefit claim and used for both engagements. This work would previously have been covered by the fee for the housing benefit certification. As such, we are proposing an additional fee of £382 for this work.

The proposed additional fees remain subject to agreement with management and PSAA.

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