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Cambridgeshire County Council

Annual Audit Letter

2014/15

Government and Public Sector

January 2016

Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.

Contents

An audit is not designed to identify all matters that may be relevant to those charged with governance. Our audit does not ordinarily identify all such matters.

Introduction

The purpose of this letter

This letter summarises the results of our 2014/15 audit work of both the Council and the Pension Fund.

We have already reported the detailed findings from our audit work to the Audit Committee in the following reports:

- Audit opinion for the 2014/15 financial statements, incorporating conclusion on the proper arrangements to secure economy, efficiency and effectiveness in its use of resources; and
- Report to those charged with Governance (ISA (UK&I) 260);

The matters reported here are the most significant for the Authority.

Scope of Work

The Authority is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As an administering Authority of a pension fund, the Authority is also responsible for preparing and publishing Accounting Statements for the Cambridgeshire Pension Fund.

Our 2014/15 audit work has been undertaken in accordance with the Audit Plan that we issued in March 2015, as updated for the matters reported in our ISA260 report, and is conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

We met our responsibilities as follows:

Audit Responsibility	Results
Perform an audit of the accounts and pension fund accounting statements in accordance with the Auditing Practice Board's International Standards on Auditing (ISAs (UK&I)).	We reported our findings to those charged with governance in September 2015 in our 2014/15 Report to those charged with governance (ISA (UK&I) 260), which was subsequently updated and issued as final for the approval of the accounts on 11 December 2015. On 15 December 2015 we issued an unqualified audit opinion on the statement of accounts and the pension fund accounting statements.
Report to the National Audit Office on the accuracy of the consolidation pack the Authority is required to prepare for the Whole of Government Accounts.	We reported to the National Audit Office on 15 December 2015 that the consolidation return was consistent with the audited statement of accounts.
Form a conclusion on the arrangements the Authority has made for securing economy, efficiency and effectiveness in its use of resources.	We issued an unqualified conclusion on the Authority's Use of Resources on 15 December 2015.

Audit Responsibility	Results
Consider the completeness of disclosures in the Authority's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work and consider whether it complies with CIPFA / SOLACE guidance.	There were no issues to report in this regard in respect of the final statement
Consider whether, in the public interest, we should make a report on any matter coming to our notice in the course of the audit.	There were no issues to report in this regard
Determine whether any other action should be taken in relation to our responsibilities under the Audit Commission Act.	There were no issues to report in this regard

Audit Responsibility	Results
Issue a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission.	We issued a certificate on 15 December 2015
Issue a report noting whether or not the pension fund financial statements in the pension fund annual report and accounts are consistent with those in the authority's statement of accounts.	On 15 December 2015 we issued an unqualified audit opinion on the statement of accounts and the pension fund accounting statements.

Audit findings for both the County Council audit and the Pension Fund audit have been included in this section

Audit Findings

Accounts

We audited the Authority's accounts in line with approved Auditing Standards and issued an unqualified audit opinion on 15 December 2015.

We noted significant issues arising from our audit within our Report to Those Charged with Governance (ISA (UK&I) 260). This report was issued to the Audit Committee on 11 December 2015. We wish to draw the following points, included in that report, to your attention in this letter.

Accounting issues - County

Prior Period Adjustments

We noted a number of proposed and actual prior period adjustments during our audit work, some of which were proposed by management. These are detailed as 1-4 below.

1. The most significant of these was in relation to a prior period error within Assets Under Construction (AUC). This resulted in a net reduction in the AUC balance of £154m. Please see details as a separate accounting issue below.

2. As part of the changes to the CIPFA Code of Practice, the Council was required to make prior period adjustments to correctly recognise its PPE balance – specifically relating to schools as detailed below.

3. The Council also initially included two other prior period adjustments. One related to the disclosure of Public Health income and expenditure. We agreed that this change should be accepted to ensure consistency year on year, but our view was that this represented a reclassification of balances, rather than a prior period restatement. The bottom line figure did not change as a result of this. This was therefore amended in the final accounts.

4. The other adjustment related to the correction of a prior period fund balance. The effects of this were immaterial, so we asked the Council to reverse this prior period adjustment. The year end position remains correct. This was therefore amended in the final accounts.

Valuation and Existence of PPE

The Council does not maintain a fixed asset register for Infrastructure assets or Assets Under Construction. We have previously reported this as a control weakness to the Council in our reports in prior years.

The combined net book value of all such assets held on the Council's draft balance sheet in respect of these balances was £887m (AUC: £189m, Infrastructure: £698m).

As a fixed asset register does not exist, we were required to perform additional procedures on our audit as detailed below.

Assets Under Construction (AUC):

AUC typically represents projects underway to build infrastructure assets and on buildings. Upon completion of any project, we would expect transfers from Assets Under Construction to these categories of PPE, or for costs to be written off if the assets concerned are not held within the Council's PPE (such as REFCUS spend).

The Balance Sheet in the draft accounts for 2014/15 published on 30 June 2015 included Assets Under

Construction (AUC) as at 31 March 2015 of £189.1m. As there was no supporting asset register we challenged management to produce an analysis supporting this value.

The resulting review by the Council identified that the AUC balance as at the year end was materially lower than that presented in the draft accounts, and consequently management undertook a comprehensive exercise to understand the various elements in the £189.1m. This involved analysing movements by AUC project going back to 2006/07 – a significant and time-consuming process to prepare and audit that resulted in the late finalisation of the accounts, and incurred significant additional time to audit.

Following this review by management the AUC balance at 31 March 2015 was demonstrated to total £36.3m. The majority of the difference related to a prior period error in recording transactions occurring between 2006/07 and 2012/13 and has therefore been accounted for as a prior period adjustment.

The Council has adjusted for this error – which is set out in detail in a newly-created Note 43 to the accounts.

From the work we and the Council have undertaken this error relates to a technical accounting issue, no evidence has been identified to suggest there is any material physical loss or failure to safeguard the Council's assets.

The £154m has been adjusted to four different areas as set out in Note 43 of the final accounts. Simplistically however, this can be represented as follows:

Adjustment	£'m
Land and buildings	4
Infrastructure assets	(11)
Revaluation reserve (Unusable Reserves)	34
Capital Adjustment account (Unusable Reserves)	127

An analysis of the net error within AUC by accounting periods is provided in the following table:

	2014/15 Amount £'000	2013/14 Amount £'000	Pre 2013/14 Amount £'000	Total £'000
Error value within AUC	2,239	(1,681)	(154,890)	**(154,332)**

As the amounts relating to 2014/15 and 2013/14 are immaterial, the Council have included these within the Prior Period Adjustment for AUC recorded within the financial statements, rather than adjusting the figures for each of those years. We have therefore included this within our Summary of Uncorrected Misstatements in Appendix 1.

There are then other consequential adjustments for accumulated depreciation. The total impact on Property, Plant and Equipment (PPE) for the adjustment is therefore to reduce the value of the Council's PPE and Unusable reserves at 1 April 2013 as shown overleaf:

These adjustments do not affect the Usable Reserves figure disclosed in the prior years' financial statements. This is of significance as it is the Usable reserves in particular that impact on the Council's decisions on Council tax levels.

	Cost or Valuation £000	Accumulated depreciation £000	Net impact £000
Increase /(Reduction) in AUC	(154,332)		(154,332)
Increase /(Reduction) in Land & Buildings	4,280	(725)	3,555
Increase /(Reduction) in Infrastructure	(10,669)		(10,669)
TOTAL INCREASE/ (REDUCTION)	**(160,721)**	**(725)**	**(161,446)**

We have performed audit procedures as follows over each adjustment category, and the £35m remaining in AUC, to ensure that the accounts are not materially misstated.

1. Obtaining detailed listings for a sample of 64 projects and agreeing this to the AUC Analysis working paper;
2. Selecting a single cost line from each project breakdown, in order to obtain evidence for the value included in that project;
3. Ensuring that the project has been allocated to the correct adjustment category in the table above; and
4. Ensuring that the proposed double entry for each adjustment category is correct.

On completion of our work, which found no material exceptions from management's analysis, we agreed with the Council the appropriate disclosures in the accounts and Annual Governance Statement for this matter. The accounts were then signed by the Council and by pwc in December 2015.

We have raised a significant control deficiency in respect of this matter.

Infrastructure:

Infrastructure assets include items such as bridges, pavements, streetlights and signs.

The current accounting policy for this asset category is to capitalise infrastructure assets at cost.

Depreciation is charged annually, but is not allocated to specific assets. 1/40th of the closing book value at year end is taken as the depreciation for the year. This represents the Council's best estimate of the average life of such assets, but we note this is not based on actual experience or set separately for each category of assets (unlike other PPE assets where componentisation is applied). This depreciation rate therefore represents an estimate for the Council in its accounts.

The Council does not maintain a fixed asset register for their Infrastructure assets balance, which means that it is not possible to agree the book value back to individual assets acquired. Assets within this category have been capitalised over many years, indeed decades, with relatively few large recent additions such as the PFI street lighting and busway. The Council has also been unable to identify alternative records to support the majority of this balance.

This means that the Council has a significant weakness in its controls around this category of PPE, as costs and values cannot be linked to the remaining underlying assets.

We have therefore faced practical issues in obtaining adequate audit evidence to support the ongoing existence of the majority of this balance in the accounts. We therefore considered the need for us to qualify the accounts on the grounds that this balance could not readily be supported. To ensure we considered the Council's position in line with all other councils, we consulted internally with our technical panel on this issue. We concluded that we did not need to qualify, due to the nature of the assets, the alternative evidence we could obtain from past audit work, and indirect evidence such as from Council minutes.

This was however subject to some amendments to clarify the Council's accounting policies in this area to make the position clearer to readers of the accounts, which have been adjusted in the final accounts. We have however flagged this as an area of significant control weakness, not least as weaknesses in asset existence controls can increase fraud risk.

We note that the accounting treatment for this asset category is changing as at the start of 2016/17, and the Council should seek to improve these controls as part of the implementation of that change.

Schools Accounting

As part of a LAAP Bulletin update affecting all Councils holding schools assets on their balance sheet, the Council were required to remove the PPE for the majority of voluntary controlled schools valued at £79m from the balance sheet, and bring on the PPE of foundation schools, valued at £75m. This gave a net effect of £4m.

We identified as part of our audit plan that the changes around schools accounting would have a material effect on the financial statements this year.

We have performed work over the PPE adjustments made by the Council to remove the appropriate voluntary controlled schools from the balance sheet and to bring the appropriate foundation schools back onto the balance sheet.

Our testing did not reveal any errors in the calculation.

We also assessed the completeness and accuracy of the balances which were adjusted in the prior year comparatives, as required by Auditing Standards. Again, no issues were noted from this work performed.

Cash

The Council's cash balance is made up of hundreds of different bank accounts held with several different banks. Many of these bank accounts are used by separate entities which are consolidated into the Councils accounts (for example schools' bank accounts).

The Council does not oversee the controls around monthly bank reconciliations, or the relationships with the banks.

We have therefore encountered issues in auditing the cash balances as,

- reconciliations have not always been performed;
- confirmations have not all been received for accounts the Council believes exist; and
- confirmations have been received for bank accounts that the Council is unaware of.

With the assistance of management, we have been able to reconcile the accounts for which we did not receive a confirmation to the accounts which were included on the GL without a confirmation.

We believe that the lack of internal controls around cash indicate an internal control deficiency.

Reconciliation of Payroll records to the General Ledger

As part of our testing of the payroll expenses included in the Council's Comprehensive Income and Expenditure Statement (CIES), we are required to audit a reconciliation between the Council's general ledger and the amounts paid through on a monthly basis to Council staff.

We recommended in the prior year that the Council should ensure that these reconciliations are happening on a monthly basis. Whilst a reconciliation is now performed by the

Council's Payroll department, this does not include all payroll costs recorded by the Council on its general ledger.

At our request the Councils' Corporate Finance department has now been able to provide us with a reconciliation of all payroll costs on the general ledger to all amounts paid through the monthly payroll runs.

Related Parties

We identified the following matters during the course of our work of which we believe the Audit Committee should be aware:

- The list of related parties presented in the draft Council financial statements and Pension Fund accounting statements was not complete.

We have performed additional procedures including review of declarations of interests and expenditure listings to consider whether all material related party transactions are disclosed. Our work did not identify any additional related parties for disclosure within the accounts

Provision for Doubtful Debts

The Council currently applies a standard percentage to each age category of outstanding debt with the exception of the Adults' team who assess each outstanding debt on its merits.

This former approach is not compliant with International Financial Reporting Standards (IFRS) but we are satisfied that the effect of this on the financial statements as a whole would not be material.

A more evidence based approach has been applied to calculating the Bad Debt Provision for sundry debtors since the prior year, and this is now calculated on the basis of age, category of debtor and an assessment of the potential recoverability of invoices. Your provision for the impairment of receivables was £0.6 million in 2014/15 (2013/14 £1.4 million). There is an inherent level of judgement involved in calculating these provisions and you rely on the knowledge of the Departments for information on specific transactions.

We have audited the provision which the Council has put in place and deem the amount to be prudent and materially correct – despite the methodology being non-compliant with the Code. A provision is put in place to account for the possibility that the Council will not receive the cash for any debtors outstanding at year end. Given that bad debt write offs are around £300k per year, and that the Council has reduced the amount of debtors it is holding which are over 1 year old from 13% (£3.2m) to 5% (£1.5m), we do not deem the Council to have under or over-estimated their provision materially.

Segregation of Duties in the accounts payable system

As we have reported to you in previous years, the Council's Accounts Payable module of the general ledger system does not have system enforced segregation of duties.

This control deficiency exposes the Council to a significant fraud risk.

The Council should seek to minimise the number of people who have conflicting responsibilities within its accounts payable and payroll teams or should implement detective controls to identify any conflicting actions undertaken during the year.

Examples of such conflicting responsibilities include the creation of a new supplier and processing of payments to that supplier.

As a result of this audit risk we asked our specialist data team to extract information showing all of the instances in the year where the same individual had changed and approved an alteration to a supplier's details. We noted 24 instances where the same user altered and approved supplier details. Only two users were noted as being involved with this, and the combined value of invoices affected was £276k which is immaterial for our audit.

Accounting issues – Pension Fund

Valuation of Cambridge and Counties bank

In previous years, the Fund has not obtained an external professional valuation of the investment in Cambridge and Counties Bank, but carried this investment at cost, as it was in the early years of trading. This year a valuation was commissioned by the pension Fund from Hymans Robertson, as an external expert.

On our review of the valuation we noted the following:

- The valuation was performed to obtain a value of the investment as at 31 December 2014. This is not the year end date for the Fund's accounts, however we are not aware of any significant changes since then that would affect the valuation. This also correlates with the bank's year end and hence the period for which the Fund has audited financial data on performance and profit.
- The valuation was performed on the value of the bank as a whole, rather that the Pension Fund's proportion. Management have then applied an estimate of 50% of the total value to calculate the Fund's element of this total value. This does not take account of the different shareholdings (equity and preference shares) of the Fund and Trinity College, and therefore misstates the Council's share of the total value. We have estimated the value if this misstatement below and recorded this on our SUM in Appendix 1.
- The valuation report suggested various calculation methods, of which the "PBT multiple" was chosen by the Fund on which to base its accounting value. We accept that the PBT multiple is one of the generally acceptable methods for setting valuation in valuing such organisations.
- The methods presented in the report showed a wide range of values, which at the extremes could materially affect the Fund's assets values in the accounts:

Method	Minimum Value £m	Central Value £m	Maximum Value £m
Investment value	n/a	41.33	n/a
Discounted Cash Flow	10.638	11.192	12.111
Revenue multiple	30.93	44.843	57.754
PBT multiple	34.578	65.199	101.76
Valuation by comparison	0	26.489	68.898
Comparison with recent floatations	37.13	79.897	113.592

- Using a PBT multiple of 9, the valuation report gave a range of values for the whole bank of £34.578m - £101.760m. This range arises from using PBT figures for various time periods – from 2014 actuals to forecast projections PBT up to 2017, discounted to present values. The largest value is based on projected 2017 PBT. We note that the valuations for projected PBT for future years have not used lower PBT multiples to reflect risks inherent in projected results, and hence we would have expected the higher values in this range to have been reduced by the Fund's expert.
- The Fund have taken the lower end of this range to calculate the value in the accounts, being: £34.578m (And then taken 50% of this as their share = £17.289m). The Fund have chosen this end of the range as they believe this to be prudent. Whilst we do not believe prudence is an appropriate reason to select a valuation, as this should be your <u>best</u> estimate of the value, for the reasons set out above we have challenged the appropriateness of the values based on future years' PBT forecasts as these are not risk- adjusted. For this reason we are not inclined to disagree with management's assumption, but the Audit Committee note that this is a significant judgement in the preparation of the Fund's accounts.

We have engaged our internal experts to review the valuation and we have noted the following:

- The valuation methods suggested by Hymans did not include the 'Price to Book' valuation method as an option. We noted in our prior year reporting that this was a common approach. As this was not provided to the Council we have recalculated using this method, and note that this appears not to be materiality inconsistent with the PBT outcome for the Fund this year. This could give a different result in future years however. Using a P/B multiple of 2, based on comparison work performed on other start up banks, this would give an approximate value of £54.2m [(net assets at 31 Dec 14) * 2 = £54.2m]. The total difference in valuation is therefore £19.6m, of which the Council's share would be is below our materiality level. This is however again a key decision in estimation that should be noted by the Audit Committee.

	31/12/2014 P/B multiple using PBT	15/06/2015 P/B multiple using PBT
Shawbrook Bank	-	3.2
One Savings Bank	2.4	3
Aldermole Group	-	2.6
Average	2.4	2.9
Low	2.4	2.6

  The above table shows the implied multiples from a small sample of banks. We have deemed an acceptable multiple for the Fund's Bank to be lower than this due to the relative size, diversity, growth prospects, profitability of Cambridge and Counties Bank.

- In order to calculate the £34.578m, the multiple has been applied to the '2014 actual PBT of £3.842m'. We however note that this inconsistent with the PBT reported in the Bank's audited financial statements of £4,092m. If a PBT of £4.092m was taken, and the multiple of 9 applied, then the overall estimate would be £4,092m x 9 = £36.828m. Therefore there is an overall difference of £2.250m in the mathematical calculation. We have been unable to obtain an explanation for this, and hence an adjustment has been proposed to reflect this as part of the adjustment below and in the SUM.

- In order to calculate the PBT value, a multiple of 9 was used. This is a critical figure for the valuation and variances in this could result in a material movement in the estimate. The Hymans report did not provide any evidence to support this figure and therefore we requested that the County approach them to seek this information. As no evidence was provided we have performed our own analysis based on benchmarking to other banks. Through this work, we have noted that a multiple of up to 12 of Profit After Tax (PAT) would appear reasonable to be used. Using this would give a value of £3.216m x 12 =£38,592m.

	31/12/2014 P/E multiple using PAT	15/06/2015 P/E multiple using PAT
Shawbrook Bank	-	21.8
One Savings Bank	14.6	15.3
Aldermole Group	-	20.9
Average	14.6	19.3
Low	14.6	15.3

  The above table shows the implied multiples from a small sample of banks. We have deemed an acceptable multiple in this case to be lower than this, due to the size, diversity, growth prospects, profitability of Cambridge and Counties Bank.

- Management have taken a 50% allocation of the valuation to calculate the balance in the accounts, based on the split of ownership of the ordinary shares. We however noted that this doesn't take into account the preference shares that are solely owned by the Fund. As such, a higher proportion of the overall value should have been included within the Fund's accounts. We have therefore proposed an adjustment to take into account the preference share nominal value and unpaid dividend for these, being an estimated increase in the value of circa. £5m. See Appendix 1.

	Total Value of Bank	Funds Proportion
Fund Estimate	**£34,578k,** per Hymans Robertson report	**£17,289k**, being 50% of total value
PwC Revaluation	**£36,828k,** being a multiple of 9 applied to the PBT per Dec 14 accounts	**£22,694k**, being: £36,828k - £8,560k (less preference shares and unpaid dividened at 31 Dec 14) = £28,268k £28,268k x 50% (equity share split) = £14,136k £14,136k + £8,560k = £22,694k
Difference	£2,250k	**£5,405k,** being the proposed adjustment

It is also worth noting that the experts were not available for further questioning of above, as the department cessed to exist in Hymans at the end of June and we were only notified, directly by them, the week before.

Use of Resources

We carried out sufficient, relevant work in line with the Audit Commission's guidance, so that we could conclude on whether you had in place, for 2014/15, proper arrangements to secure economy, efficiency and effectiveness in your use of the Authority's resources.

In line with Audit Commission requirements, our conclusion was based on two criteria:

- that the organisation has proper arrangements in place for securing financial resilience; and
- that the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

To reach our conclusion, we carried out a programme of work that was based on our risk assessment. Key elements of this assessment are summarised below.
We issued an unqualified conclusion on the ability of the organisation to secure proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

The Medium Term Financial Strategy (MTFS)

The Council has a material gap between required savings in the next 5 years, and the plans in place and reserves available to bridge this gap. A table demonstrating this has been included below.

	£'m
Cumulative Savings required by 2019/20	**410**
Less: Cumulative "Intended" Savings	(385)*
Add back: Cumulative Savings as yet unidentified	149
Savings "Gap"	**174**
Usable reserves	**84**

*We note that the Councils management believe this figure to be £410m. Our work performed on the MTFS shows the figure as stated at £385m. This variance does not affect our value for money conclusion.

Over the next 5 years the MTFS sets out that the Council expect their cumulative gross budget to be approximately £3,801m. The £410m savings required over this period therefore represents approximately 10.7% of the Council's estimated expenditure over the next 5 years.

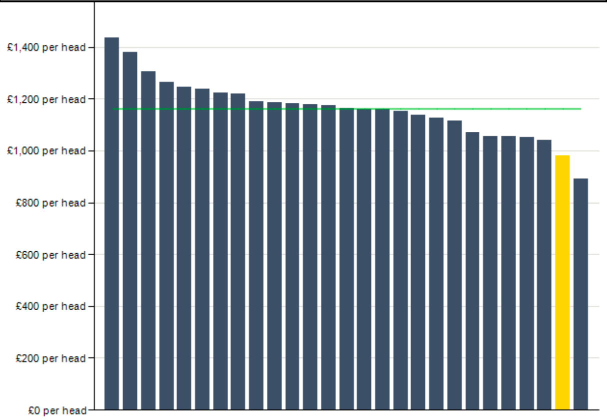
Benchmarked Data

1. *Efficiency compared to other councils*

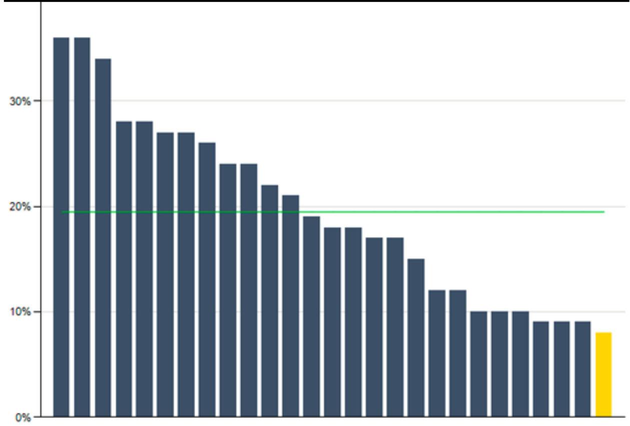
We have benchmarked the relative efficiency of the Council in a number of categories using the PSAA value for money tool.

We note that when compared to other County Councils and other geographically close Councils, Cambridgeshire sits in the lowest 10% of authorities in terms of "Planned net current expenditure per head of population" this means that the available funding per person in Cambridgeshire is lower than 90% of other authorities. We looked into more detail on this metric, and noted that the Council also sits in the bottom 25% for "Planned funding from central government (adjusted) per head of population" (meaning that the amount of funding per person is lower than 75% of the rest of the country) and in the lowest 5% in relation to "Planned total reserves at the end of the year as a percentage of revenue expenditure (adjusted)" – meaning that the level of reserves per person within Cambridgeshire is lower than almost all other County Councils.

Planned net current expenditure per head of population.



Planned total reserves at the end of the year as a percentage of revenue expenditure (adjusted).



The Council sits in the middle third for "Planned total service expenditure (adjusted) per head of population" and in the top third for "Planned revenue expenditure (adjusted) per head of population".

The implications of all this for Cambridgeshire County Council are that effectively, the residents in Cambridgeshire have less money spent on them per head than most other County Councils in England. Despite this, the Council has lower reserves than most other County Councils. This shows the clear financial challenge faced by the Council.

2. *MTFS Assumptions*

The key assumptions included within the MTFS include the following:

- Inflation

	2015/16	2016/17	2017/18	2018/19	2019/20
Inflationary cost increase (£000)	9,655	9,863	8,946	9,344	9,237
Inflationary cost increase (%)	2.0%	2.1%	1.9%	2.0%	2.0%

Relating to inflation, the MTFS shows that the Council expect to encounter costing pressures of around 2% each year.
We have compared this to two other similar County Councils, who both used a flat 2% inflation rate across the 3 years of their MTFS's. We therefore consider the assumptions around inflation made in the Cambridgeshire MTFS to be consistent with other councils.

- Demographic

	2015/16	2016/17	2017/18	2018/19	2019/20
Demographic cost increase (£000)	9,596	9,935	10,268	10,316	10,667
Demographic cost increase (%)	2.0%	2.1%	2.2%	2.3%	2.3%

Similarly, demographic pressures within the MTFS are shown to drive cost increases of approximately 2% per annum.
We have compared this to two other similar County Councils. As expected, the demographic assumptions across the three vary more than inflation does, as this is driven by local factors. However, the 2.0% to 2.3% figure used by the County sits towards the top end of the ranges we benchmarked to measure demographic pressures. The range from the other two Councils considered show a low of 0% increase to a high of 1.64% - although in both instances, the MTFS only considers the next 3 financial years.

- Funding

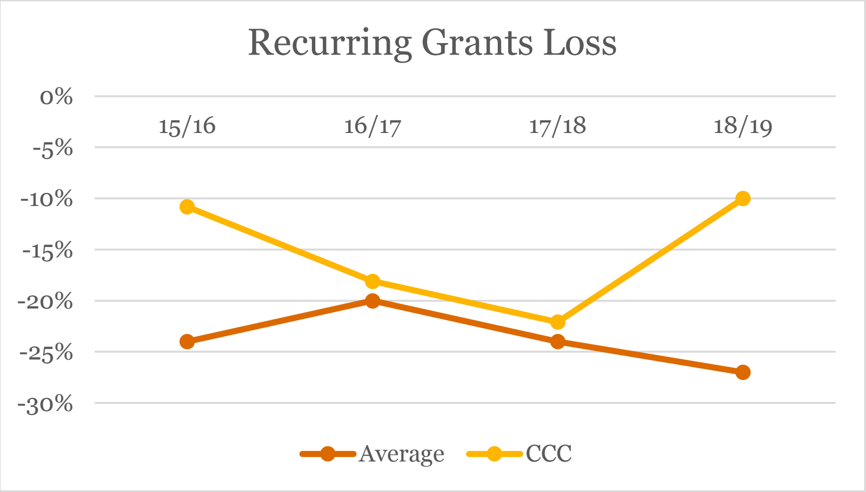
	2015/16	2016/17	2017/18	2018/19	2019/20
Government Grants (£m)	123	111	94	77	70
Business Rates (£m)	59	62	65	67	69
Fees & Charges (£m)	82	85	87	88	90
Council Tax (£m)	244	252	261	270	279
Schools Grants (£m)	260	256	253	250	247
Total Funding (£m)	**768**	**766**	**760**	**752**	**755**

The above table shows that the Council's MTFS indicates that the expectation is that funding will decrease slightly each year, but remain largely consistent with current levels.

We compared the funding decreases to two other County Councils in the South East, and noted that the estimated cuts to funding in those Councils ranged between 2% and 10% in total over the next 3 years. This would indicate that the Cambridgeshire projections might be optimistic on this measure, as these show up to only a 1% reduction in funding over the 5 years. We note that for every £ that this assumption is optimistic because funding levels are lower, the Council will need to find matching additional savings plans to meet the gap.

We note that Cambridgeshire County Council are projecting a fall in recurring government grants over the period. We have shown below the Council's assumptions on future government grants against other councils nationally. As shown, the Council is broadly in line with the consensus except in 2018/19 when the Council appears relatively optimistic.

In its planning, we further note that the Council anticipates that these funding reductions will be offset in partly an anticipated increase in Council Tax income, driven by the population increases in the County.



Past performance in delivering savings targets

We have also looked into how successful the Council has been at delivering against past savings plans. This has involved looking into the success of savings plans for 2013/14, as well as how the Council has delivered in this financial year (2014/15).

Savings plans are written into the budgets for the year. Having reviewed performance against budget for each of the services, we have not noted significant issues regarding the Council's historic achievement against savings plans.

Analysis of savings requirements included within the MTFS

Savings Requirement					
£'000	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Total New Savings Requirement for the Year	**29,797**	**33,277**	**25,366**	**20,798**	**9,709**
2015-16 Ongoing Savings		29,797	29,797	29,797	29,797
2016-17 Ongoing Savings			33,277	33,277	33,277
2017-18 Ongoing Savings				25,366	25,366
2018-19 Ongoing Savings					20,798
Total Savings Requirement for the Year (Including ongoing savings)	**29,797**	**63,074**	**88,440**	**109,238**	**118,947**
Cumulative Savings Requirement	**29,797**	**92,871**	**181,311**	**290,549**	**409,496**

The above table indicates the savings requirements year on year as identified by the Council, as well as ongoing savings required.

The "intended" areas analysed by service can be seen below. Note that this is currently below the requirement above.

Intended Savings Plans					
£'000	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Total New Intended Savings for the Year	**- 27,910**	**- 31,705**	**- 23,017**	**- 20,021**	**- 9,038**
2015-16 Ongoing Savings		- 27,910	- 27,910	- 27,910	- 27,910
2016-17 Ongoing Savings			- 31,705	- 31,705	- 31,705
2017-18 Ongoing Savings				- 23,017	- 23,017
2018-19 Ongoing Savings					- 20,021
Total Intended Savings for the Year (Including ongoing savings)	**- 27,910**	**- 59,615**	**- 82,632**	**- 102,653**	**- 111,691**
Cumulative Intended Savings	**- 27,910**	**- 87,525**	**- 170,157**	**- 272,810**	**- 384,501**

Of the £385m intended savings, we note however that £149m relates to savings which have not been identified in detail. These mainly relate to the final three years considered within the MTFS, with no unidentified savings relating to 2015/16. A summary of unidentified savings per year is as follows.

Unidentified Savings Plans					
£'000	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Total New Unidentified Savings for the Year	**-**	**- 15,889**	**- 12,047**	**- 20,021**	**- 9,038**
2015-16 Ongoing Savings		-	-	-	-
2016-17 Ongoing Savings			- 15,889	- 15,889	- 15,889
2017-18 Ongoing Savings				- 12,047	- 12,047
2018-19 Ongoing Savings					- 20,021
Total Unidentified Savings for the Year (Including ongoing savings)	**-**	**- 15,889**	**- 27,936**	**- 47,957**	**- 56,995**
Cumulative Unidentified Saving	**-**	**- 15,889**	**- 43,825**	**- 91,782**	**- 148,777**

The savings gap the Council faces can thus be seen below -

Savings Gap					
£'000	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Cumulative Savings requirement	29,797	92,781	181,311	290,549	409,496
Cumulative Intended Savings	- 27,910	- 87,525	- 170,157	- 272,810	- 384,501
Gap	**1,887**	**5,256**	**11,154**	**17,739**	**24,995**
Add Cumulative unidentified savings	-	15,889	43,825	91,782	148,777
Total Savings Gap	**1,887**	**21,145**	**54,979**	**109,521**	**173,772**

The Council currently has £84m of usable reserves. Therefore, if none of the savings plans relating to unidentified plans were realised, the gap could be covered by reserves until 2018/19. This gives the Council some time to assess their position and target other areas for savings.

Other considerations

We note that the Council has approximately £79m of loans which can be classified as Lender Option Buyer Option, or LOBO's. These impact on our value for money considerations as, on an annual basis, the Council may have to agree to a higher interest rate, or repay the entire loan amount.

These loans could represent poor value for money if the Council needed to accept high interest rates to obtain necessary funding. For the Council we note that the interest rates currently being imposed on these loans range from 2.8% to 4.0%, which is in line with the Council's non-LOBO loans and hence does not give any cause for concern re value for money.

Conclusion

We have concluded that the Council can cover the necessary savings requirements for the next 3 financial years through the use of reserves, through the successful implementation of planned savings schemes. We would not necessarily expect the Council to have detailed savings plans in place beyond this time period.

However, there is a need for significant savings to be met over the medium term. There is currently no overarching plan to assist the Council in meeting their required cuts.

Our review has shown that the Council are considering the areas which we would expect to make savings at a service level, however it will become more challenging over time for the Council to continue to meet savings targets in this manner.

Compared to other Councils, in our view the Council are behind in implementing a larger, County-wide strategy and transformation plan. A transformation programme which includes integrated savings plans across all services as wholesale changes is likely to be needed to be able to meet the required savings in later years and place the Council in long term financial balance.

Annual Governance Statement

Local authorities are required to produce an Annual Governance Statement (AGS) that is consistent with guidance issued by CIPFA/SOLACE. The AGS accompanies the Statement of Accounts.

We reviewed the AGS to consider whether it complied with the CIPFA/SOLACE guidance and whether it might be misleading or inconsistent with other information known to us from our audit work.

We found no areas of concern to report in this context, other than requesting the Council revise the AGS to cover the matters arising following the uncovering of the material prior period error in relation to Assets Under Construction

Whole of Government Accounts

We undertook our work on the Whole of Government Accounts consolidation pack as prescribed by the National Audit Office. The audited pack was submitted on 15 December 2015. We found no areas of concern to report in this context.

Other matters reported to those charged with governance

Control recommendations

These are the matters we consider to be **most significant** for the Authority and have been raised with those charged with governance. Other, less significant recommendations have been brought to the attention of the Director of Finance.

County or Pension	Deficiency	Recommendation	Management's response
County	**Assets under construction projects are not being transferred out of AUC on completion, or written off on a timely basis**	We would recommend that management perform a regular review of the newly created AUC asset register to ensure that any projects which need to be written off or transferred on completion have been posted on a timely basis.	Now that an asset register has been created for Assets Under Construction, this will be reviewed annually as part of the closing of the accounts. All projects included within the asset register (rather than simply those that have experienced in year additions) will be assessed as to whether they have completed and need transferring out of the AUC category.
County	**The year end review process to remove all non-capitalisable spend from AUC is not functioning effectively.**	This control acts as a back-stop to the above control point, but we would recommend that management ensure that a thorough review is undertaken of the entire AUC listing to ensure that no non-capitalisable spend is held within AUC at year end.	The process for reviewing non-capitalisable spend contained within AUC was reviewed and updated and as such will continue to be implemented moving forward.

County and Pension	**The Oracle accounting system does not prevent staff from posting and authorising their own journals**	The Council should look to implement an independent review process for any journals posted over a certain value.	Although this is technically correct, authorisation of journals indirectly happens through monthly budgetary control procedures and balance sheet reconciliation i.e. any anomalies would be identified and acted on.
County	**There is no fixed asset register detailing individual fixed assets held for Infrastructure assets, which ties to the accounts.** **These categories represented a net book value totalling £687m in the Councils account for 2014/15.**	The Council should collate and maintain a listing of all assets to record all asset movements from this point forward. We also recommend that an exercise is undertaken to trace back all older assets which are currently included within the historic PPE balance to ensure that they are correctly categorised, and recognised at the appropriate value, and that they still exist. Relating to infrastructure, the Council are already planning to undertake an exercise such as this due to the CIPFA Code of Practice changes taking effect from 2016/17.	Due to the change in the Code of Practice being implemented in 2016/17, the Council has already worked up an asset register (albeit on a different valuation basis to that which is used currently). Therefore, this issue is already being addressed, but won't be fully implemented until the 2016/17 accounts.
County and Pension	**A list of related parties is not held and maintained by the Council.** **Returns from members and councillors are not filled out with a sufficient level of detail and omit information about interests held.**	The Council and the Pension Fund should maintain a related parties listing at all times so that the risk of engaging with a related party is mitigated.	The Finance and Pension Fund teams will engage with democratic services/ members/ senior officers during 2015/16 to establish a full listing of interests held by members/ senior officers. This can then be reviewed on a regular basis so that potential Related Parties can be flagged.

County	**Lack of segregation of duties within the accounts payable cycle module in Oracle**	The Council should seek to minimise the number of people who have conflicting responsibilities within its accounts payable or should implement detective controls to identify promptly any conflicting actions undertaken during the year. Examples of such conflicting responsibilities include the creation of new suppliers and processing of payments to suppliers.	All work has been completed in line with the framework document for access controls. All existing payables/purchasing responsibilities have been reviewed and in scenarios where conflicting responsibilities existed then the responsibilities were updated accordingly. A quarterly report is also being completed to confirm that review users responsibilities are appropriate to individuals roles.
Pension	**Valuation of the Cambridge and Counties bank was not commissioned to the required standard**	We would recommend that the Fund ensure that the valuation which is commissioned for the next financial year includes details from our findings this year (see pages 17 and 18 for details) to ensure that the work undertaken considers all of the relevant assumptions and includes the correct details regarding the Fund's ownership. We also recommend that sensitivities are performed on assumptions used.	Accepted Officers will review the most appropriate method taking into account all feedback.

Final Fees

Final Fees for 2014/15

We reported our fee proposals in our audit plan.

We varied our fee for the following reasons:

Council and Pension fund fees (Note 1):

In line with the Audit Commission's guidance, as part of our audit plan that was presented and approved, the indicative fee was adjusted to reflect the known audit risks and additional work at that time.

Based on our planning work we identified that there were specific risks to the Council and Pension Fund that required additional work to address the local risks. These were approved as part of our audit plan, and we will therefore seek approval for a fee variation from PSAA.

Council

In particular, the financial position of the Council has substantially increased our audit risk and hence our audit work associated with:

- Risk of fraud in management override of controls; and
- Risk of fraud in revenue and expenditure recognition.

The challenging financial position of the Council has also increased the level of work we are required to perform on value for money: the extent of the gap in the Medium Term Plan, with a forecast gap in the Medium Term Plan of £410m over the next 5 years means that have assessed the risk in respect of our value for money work as **significant**. As such we needed to undertake additional risk-based work around the Council's future financial plans and on the extent and robustness of its savings plans.

Our plan also included a significant risk associated with the Fixed Asset Accounting, as in FY14. Given the size and the nature of this balance, the manual input to this accounts area and judgements involved, additional work is required in relation to this balance. This area has also historically seen large adjustments, therefore required increased focus for this Council.

We also noted that there has been a change in the accounting policy for Accounting for Schools. This resulted in prior year adjustments that required auditing as well as detailed testing and review in relation to the work undertaken by the Council to these changes.

Pension Fund

Our plan initially identified an elevated risk in relation to the valuation of investments, including the valuation of the Cambridge & Counties Bank for the first time. This valuation has been undertaken by external valuers on behalf of the Council. We needed to perform additional work to assess the external valuer's work and assumptions in the current year, including the need to involve our own valuation specialists.

During the year there has also been a change in the custodian. Additional work was therefore required in the current year to understand new processes/procedures and also reviewing their reporting.

These scope changes were agreed at the planning stage with the Council and are currently with the PSAA for their approval before billing.

Scope Changes (Note 2)

This increase relates to the change in our audit risk level from **elevated** to **significant** for the valuation of the Cambridge and Counties bank investment, and also the extra work required due to issues identified with the evidence to support this valuation.

We also received a number of other audit deliverables late, including most significantly our journals data download, which was requested on the 3 June, but not received until the 15 July. Furthermore, we requested payroll reconciliations on 22 July, but the final deliverable was received 24 August. Both of these items were included on our initial deliverables schedule which was sent to management in advance of our on-site time on 2 March.

This scope change of £8k has been agreed with the Council and are currently with the PSAA for their approval before billing.

Scope Changes – AUC (Note 3)

This fee element is in relation to significant issues encountered whilst auditing PPE. This meant that we had to undertake significant additional work and involve our internal technical panel of technical experts on several occasions to resolve the matter from both an accounting and an auditing perspective.

In particular in auditing Assets Under Construction – as noted earlier in this report – which has added approximately 10 weeks to our audit timetable and has required the involvement of a technical panel of experts, as well as heavy engagement leader and engagement manager input to resolve.

The proportion of these costs that have been agreed for payment by the Council is £35k, and this is currently with the PSAA for their approval before billing.

Our fees charged were therefore as follows:

Audit Fee	**Outturn 2014/15 £**	**Fee Proposal 2014/15 £**	**Actual Fees 2013/14 £**
Audit work performed under the Code of Audit Practice	125,415	125,415	125,415
- Statement of Accounts			
- Conclusion on the ability of the organisation to secure proper arrangements for the economy, efficiency and effectiveness in its use of resources			
- Whole of Government Accounts			
Pension Fund	22,410	22,410	22,410
Total Agreed Scale Fee	147,825	147,825	147,825
Additional Audit Work to Respond to Local Risks			
Council (Note 1)	16,000*	16,000	13,262
Pension Fund (Note 1)	15,000*	15,000	19,553
Scope changes (Note 2)	8,000*	-	-
Scope change - AUC (Note 3)	35,000*	-	-
Total Audit Code work	**221,825**	**178,825**	**180,640**
Planned non-audit work			
Teachers' Pension grant procedures	10,000	10,000	10,000
VAT Helpline	3,670	3,670	2,000
VAT Advice on Guided Busway	-	-	8,000
Total fees (audit and non-audit work)	**235,495**	**192,495**	**200,640**

* To be agreed with PSAA Ltd

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