Annual Audit Letter 2015/16

Northampton Borough Council

October 2016

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Contents

This Annual Audit Letter summarises the outcome from our audit work at Northampton Borough Council (the 'Authority') in relation to its 2015/16 audit year.

Although it is addressed to Members of the Authority, it is also intended to communicate these key messages to key external stakeholders, including members of the public, and will be placed on the Authority's website.

Value for money

Based on the work carried out on the Authority's 2015/16 value for money (VFM) risk areas, the Authority did not put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

VFM conclusion

We issued an adverse conclusion on the Authority's arrangements to secure value for money (VFM conclusion) for 2015/16 on 28 September 2016. We have concluded that the Authority has not made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

To arrive at our conclusion we looked at the Authority's arrangements to make informed decision making, sustainable resource deployment and working with partners and third parties.

VFM risk areas

We undertook a risk assessment as part of our VFM audit work to identify the key areas impacting on our VFM conclusion and considered the arrangements which the Authority has put in place to mitigate these risks.

Our work identified the following significant matters:

VFM risk 1: Northampton Town Football Club loan

- In July 2013, the Authority approved in principle a loan to Northampton Town Football Club (NTFC) to carry out works to improve stadium facilities at Sixfields and to develop an adjoining hotel. A total of £10.25 million was drawn down by NTFC in various tranches, beginning in September 2013. Of the £10.25 million, £31,000 has been repaid to the Authority.
- Following failure by NTFC to make due payments on the loan interest between May and September 2015, the Authority exercised its rights under the loan agreement and required immediate repayment of the outstanding £10.22 million. The Authority has since written-off the outstanding loan and have undertaken actions to recover this fund. In November 2015, Cabinet approved £450,000 to finance the cost of recovering the lost monies. These funds have now either been spent or committed. On 13 July 2016, Cabinet agreed to allocate an additional amount up to £500,000 to continue its efforts into recovering lost funds.
- Our review into the circumstances surrounding the loan as well as subsequent actions undertaken is not yet complete due to the on-going police investigation. We have considered the information and findings arising to date from our review as part of our VFM conclusion. However, we are unable to comment further on the findings of this specific review until our work is complete. This work will also address the issues contained within the objection received on the financial statements in relation to the NTFC loan. Due to the circumstances surrounding the loan and the ultimate loss of £10.22 million of taxpayers' money by the Authority, we are not satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to loans is adequate. We have thus issued an adverse VFM conclusion.

VFM risk 2: Financial resilience

- Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. At a local level, this is compounded by the County Council's financial difficulties.
- The Authority reported an overall breakeven position on its net expenditure budget for 2015/16 after the net contribution of £4.5 million from the Earmarked General Fund reserve. This enabled the General Fund balance to remain at £5.5 million as of 31 March 2016.

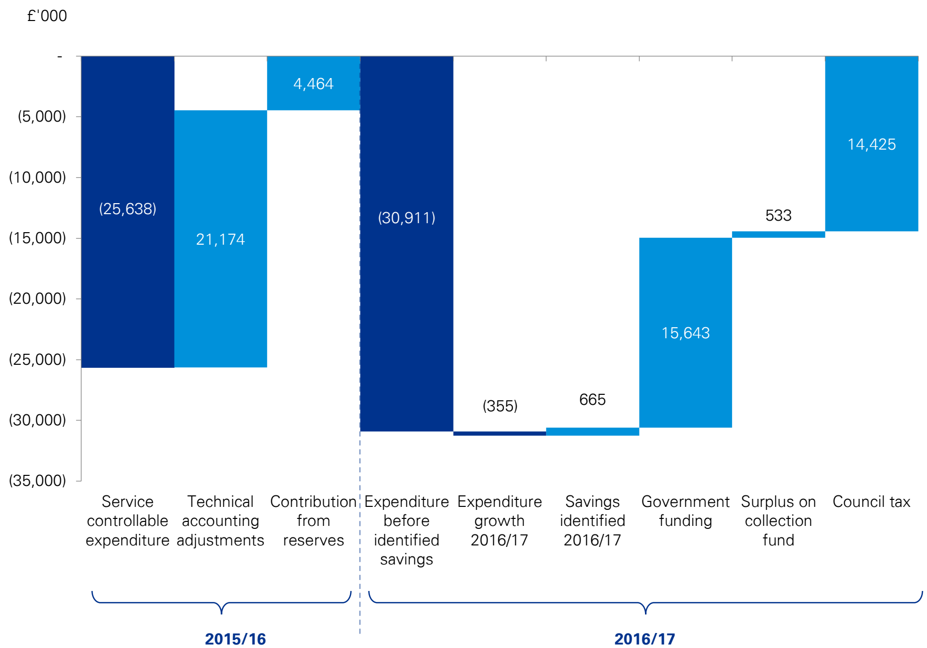
(continued overleaf)

Value for money (cont.)

– The Authority's Medium Term Financial Plan (MTFP) details a balanced budget for 2016/17 including savings of £665,000 in year, all of which have been identified. However, the MTFP details the increasingly difficult financial challenges faced each year, resulting in the need for ever rising savings which have yet to be identified, up to £7.3 million by 2020/21.

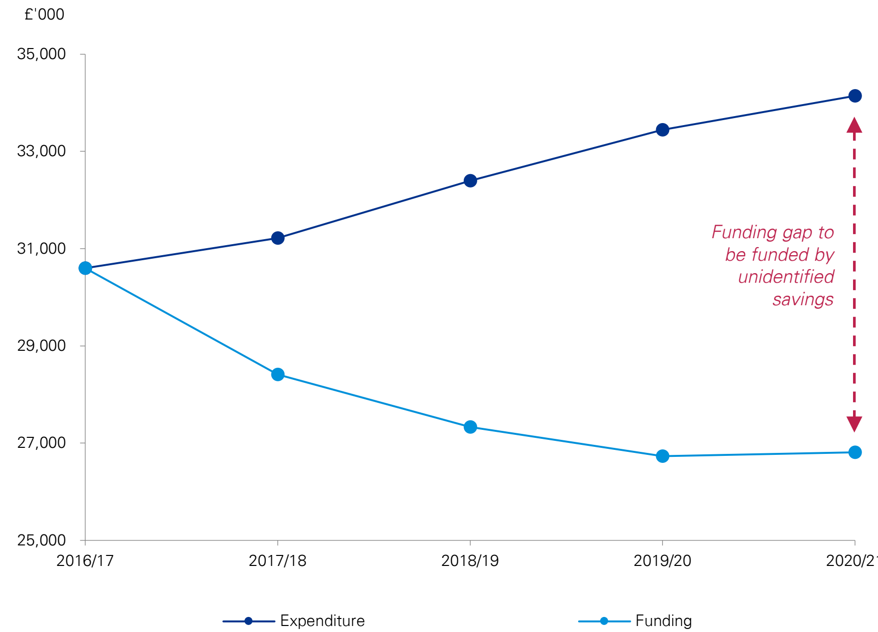
– Thus for 2015/16, we concluded that this identified VFM risk is not a cause for an adverse conclusion on the Authority's arrangements to secure value for money.

Chart 1: Income & expenditure bridge



The bridge above shows a breakdown of key measures undertaken by the Council in 2015/16 to achieve a net position in year. The bridge continues for 2016/17 and includes the identified savings (£665,000) needed to achieve a net position for 2016/17.

Chart 2: Future funding gap



The chart above shows that, whilst not a concern in the near future, the Authority faces increasingly challenging years from 2017/18 onwards.

Financial statements

We did not identify significant audit differences as part of the audit.

Audit opinion

We issued an unqualified opinion on the Authority's financial statements on 28 September 2016. This means that we believe the financial statements give a true and fair view of the financial position of the Authority and of its expenditure and income for the year.

Audit adjustments

There were no significant adjusted or unadjusted audit differences identified as part of the audit. We identified one unadjusted non-significant audit difference in relation to the way in which the Authority calculates the derecognition of Council Dwellings components. The change in the calculation of derecognition of components introduces an element of estimation. The impact is immaterial in the current financial year, but is anticipated to be a material balance going forwards.

Significant audit risk: loans system

During our planning stage, we identified that the Authority's loans system represents a significant audit risk. In our *External Audit Report 2015/16* issued in September 2016, we stated that our work on the Authority's loans system was still outstanding. We have since completed the work (with the exception of the NTFC loan, see page 4) and have identified the following:

- For one loan, the Authority was unable to locate a copy of the loan business plan. This represents a significant risk as the Authority is unable to substantiate key decisions, including the facts underpinning its decision to grant the loan.
- For one loan, the collateral secured against it was a guarantee by the applicant's parent company. A credit check on the parent company indicated a 'higher than average' risk of business failure, with the loan offered far exceeding the suggested maximum credit limit on both the parent and the loan applicant. It is unclear if the Authority had assessed and mitigated this risk.

The Authority was not able to find a number of key documents or evidence. Nonetheless, we are satisfied that there is no risk of material misstatement to the financial statements.

Accounts production and audit process

As stated above, we experienced delay in the provision of supporting documents for our work on the Authority's loans system. The Authority was not able to locate a number of documents for the audit. These have still not been provided at the time of our Annual Audit Letter. We have reported these issues in our *External Audit Report 2015/16*.

We found issues in relation to the working papers, both in relation to the delay in provision of some key working papers previously requested, and also the quality of evidence provided to support the financial statements, specifically in relation to fixed assets. There is an opportunity for improvements to be made in providing clear and concise audit trail of underlying transactions. This has caused significant delays and placed additional pressures on the audit.

Other

We have raised one high-priority recommendation this year. We have also raised one additional low-priority recommendation since completion of the outstanding audit areas.

Annual Governance Statement

We reviewed the Authority's Annual Governance Statement and concluded that it was consistent with our understanding.

Whole of Government Accounts

The Authority prepares a consolidation pack to support the production of Whole of Government Accounts by HM Treasury. We are not required to review the Authority's pack in detail as the Authority falls below the threshold where an audit is required. As required by the guidance we have confirmed this with the National Audit Office.

High-priority recommendations

We raised one high-priority recommendation as a result of our 2015/16 audit work. This is detailed in Appendix 1 together with the action plan agreed by management.

In our *External Audit Report 2015/16* issued in September 2016, we stated that our work on fixed assets, loans and provisions for the Authority's business rates (NDR) was still outstanding. We have since completed our work and as a result of this, issued one further recommendation, which brings the total recommendations raised for our 2015/16 audit to nine. This new low-priority recommendation is listed in Appendix 2 for completeness.

We will formally follow up these recommendations as part of our 2016/17 work.

We raised three recommendations in the prior year, of which only one was fully implemented. We have listed the incomplete high-priority recommendation in Appendix 3, management's original response, as well as our assessment of implementation as of September 2016.

Certificate

We have received an objection to the Authority's financial statements in relation to the loan to Northampton Town Football Club, which we are currently considering. This means that we are not yet able to issue our certificate.

Audit fee

Our scale fee for 2015/16 was £80,775, excluding VAT (2014/15: £106,800). This represents a 24% reduction against the scale fees set by Public Sector Audit Appointments Limited. We anticipate that our final fee will be higher than the planned fee of £80,775. Our final fee for the 2015/16 audit of Northampton Borough Council is still subject to final determination by Public Sector Audit Appointments Limited. We will provide a further update at the Audit Committee. Further detail is contained in Appendix 5.

Appendix 1: High-priority recommendations

We raised eight recommendations in our *External Audit Report 2015/16 (ISA260)*. Here we have listed the one high-priority recommendation.

High priority

1. Controls and processes for issuing loans

There is no systematic formalised system of recording or documenting the due diligence process or results arising from the loan approval process. This includes the assessment of business cases, evidence to support key decisions made, any challenge put forward by the Authority to the loan applicant, and the Authority's internal review and approval process. The Authority had significant difficulty in obtaining the evidence required to substantiate this decision-making process. Our assessment of two loans is still on-going due to the delayed provision of key documentation first requested in February 2016.

There is evidence that the due diligence process is not sufficiently formal nor are there a consistent set of requirements. This includes the lack of assessments regarding historic trading performance, cash flow, working capital requirements, sensitivity analysis, etc. The Authority's Treasury Management Strategy, states that *"The Council will use specialist advisors to complete financial checks to ascertain the creditworthiness of the third party."* We note that the use of specialist advisors by the Authority varies across loans in relation to the scope and detail of work requested and undertaken.

The accountability and decision-making process is not sufficiently robust. We note that whilst Cabinet delegates authority to the Chief Executive or other appropriate Officers, this has been done prior to finalising the due diligence process.

Recommendation

The Authority should put in place a systematic, robust, and objective process of assessing and documenting the due diligence procedures carried out on loan applicants. This process should be transparent and the due diligence process undertaken by qualified individuals. Any decision will need to be fully documented, including the reasoning and consideration of risks. The process should include a review by a senior officer and this should be evidenced.

Decision papers to Cabinet need to be robust and objective in order to allow informed and balanced decision-making. Decisions need to be made by Cabinet upon completion of required due diligence process. Officers will need to seek subsequent approval if terms of the loan are substantially revised.

Accepted.

Management accept that improvements should be made to the process for approving loans.

It should be noted that NBC have implemented a number of improvements in more recent loans issued, in particular the £46m loan to the University of Northampton which was subject to an intense and closely scrutinised process by the Council and external bodies, including HM Treasury.

NBC will conduct a thorough governance review, in relation to project governance, risk management and due diligence. This review will consider Cabinet decision-making and clearance processes.

The review will draw on external and internal experts and will work closely with KPMG and PWC as appropriate, and the output from the review will include documented and robust processes and checklists for the approval of loans and decision-making processes. NBC using advice from KPMG have already introduced a summary checklist to ensure that all aspects of third party loans are appropriately considered and recorded prior to approval.

Responsible Officers

Chief Finance Officer, and Monitoring Officer

Deadline

31 March 2017

Appendix 2: Additional recommendation

We stated in our *External Audit Report 2015/16* issued in September 2016 that our work on fixed assets, loans and provisions for the Authority's business rates (NDR) was still outstanding. We have since completed our work and as a result of this, issued one further recommendation which is listed below. This brings the total recommendations raised for our 2015/16 audit to nine.

Low priority

1. NDR provision review

The Authority collects Non-Domestic Rates (NDR) from businesses in the Borough. NDR owed to the Authority is based on rateable values, as set by the Valuation Office Agency (VOA). Ratepayers are able to appeal these values if they do not agree with the valuation. If successful, the Authority is liable to repay its share of the difference.

This was first introduced in 2013-14 due to a move to localise business rates. The Authority has set an NDR provision level of 5% based on an estimate of successful appeals. This estimate is based on information from the VOA (across a range of percentages) and the DCLG's guidance on the national average success rate.

During the course of the audit we asked the Authority to provide evidence regarding its review and analysis of local historical data collected since April 2013 in order to inform its view of the appropriateness of its provision in this area, however none was provided at that time. In raising this issue with Management, we have now been provided with information pertaining to the Authority's approach. The Authority having analysed the local data has deemed that the current approach is prudent and therefore has not adopted the calculated figures. This has not resulted in a material impact on the financial statements.

Recommendation

The Authority should continue to use its own historical data to inform and refine its estimate of its share of liability arising from successful appeals. Notwithstanding whether the Authority decides it should change its provision based on this information, sufficient and appropriate audit evidence should be maintained and provided to evidence the decision process undertaken, as well as management review and sign-off of the final position. The Authority should provide appropriate and sufficient narrative explanations with regards to why the Authority believes that the approach taken is the most appropriate or prudent, especially when there are valuation differences between methodologies.

Accepted.

The Council recognises the complexity of the business rates retention system and the importance of understanding its appeals position. The Council will continue to review the impact of successful appeals on a monthly basis to assess its impact on the financial position. The outcome of this analysis, along with other sources of intelligence, will inform the level of appeals provision for 2016/17.

Responsible Officers

Chief Finance Officer

Deadline

31 March 2017

Appendix 3: Prior year recommendations

As part of our audit work we followed up on the Authority's progress against previous audit recommendations. The Authority has not implemented two of the three recommendations in our *ISA 260 Report 2014/15*. This Appendix summarises the outstanding high-priority recommendation identified in our ISA 260 Report 2014/15 and progress made as of September 2016.

High priority

1. Retrospective raising of purchase orders

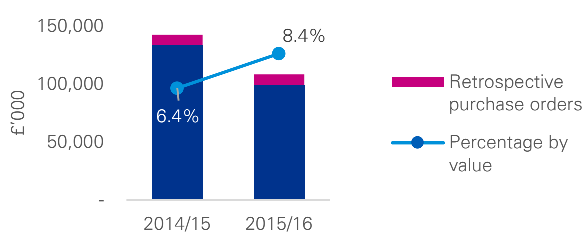
Testing identified that purchase orders need to be raised prior to the Authority committing itself to purchasing goods/services. All purchases need to be authorised, and this authorisation is only carried out at purchasing order stage for those items that require a purchase order.

We noted that £7.7 million worth of expenditure in year was not appropriately authorised prior to placing an order with a supplier. In these cases purchase orders were raised retrospectively which potentially opens the Authority to potential fraud or impropriety and is contrary to the Authority's policy.

Recommendation

The Authority should ensure that purchase orders should be raised for the purchasing of goods and services through the purchase order process (where appropriate), prior to the Authority committing itself to the purchase.

Reports should be run on a regular basis to identify all non compliance and take appropriate follow up action.



2014/15 response

Agreed. This amount of expenditure (£7.7 million) represents approximately 3% of the value of all invoices raised in 2014/15.

This indicates a good level of financial management with 97% of purchases requiring a purchase order being processed appropriately.

All purchases made were from approved budgets and were subject to appropriate segregation of duties for final authorisation of payment.

The Authority will review this level of efficiency and continue to provide financial management training to further improve procurement compliance.

Responsible Officers

Chief Finance Officer

Deadline

Quarterly review

Partially implemented. Reiterated.

In the Authority's response to our 2014/15 recommendations, the Authority stated that of the £7.7 million retrospective purchase orders identified from April 2015 to January 2016, the majority (£5.3 million) relate to contract expenditure and appropriate procurement procedures had taken place. This leaves £2.2 million (2.5%) which appear to have bypassed procurement procedures during that period, and the issue of retrospective purchase orders still remains.

Scheduled payments under contracts can be anticipated, thus there is no need for the purchase orders to be initiated retrospectively. Our review at year end indicated that there were 885 retrospective orders raised, totalling £9.1 million. This is an increase from the prior year (£7.7 million).

A formal report was taken to the management board in autumn last year, and the Authority has stated that from January 2016 monitoring of non-compliance has been integrated into the Management Board dashboard report. However, the report does not currently indicate any actions taken on non-compliance.

Appendix 4: Summary of reports issued

This appendix summarises the reports we issued since our last Annual Audit Letter.

2016

January

February

March

April

May

June

July

August

September

October

November

December

Accounts Audit Protocol (January 2016)

The Accounts Audit Protocol sets out our requirements in terms of audit documentation.

Certification of Grants and Returns (January 2016)

This report summarised the outcome of our certification work on the Authority's 2014/15 grants and returns.

External Audit Plan (March 2016)

The External Audit Plan set out our approach to the audit of the Authority's financial statements and to work to support the VFM conclusion.

Interim Audit Letter (April 2016)

The Interim Audit Letter summarised the results from the preliminary stages of our audit, including testing of financial and other controls.

Audit Fee Letter (April 2016)

The Audit Fee Letter set out the proposed audit work and draft fee for the 2016/17 financial year.

Auditor's Report (September 2016)

The Auditor's Report included our audit opinion on the financial statements along with our VFM conclusion. We are not able to issue our certificate due to the objection to the Authority's financial statements in relation to the loan to Northampton Town Football Club, which we are currently considering.

Report to Those Charged with Governance (September 2016)

The Report to Those Charged with Governance summarised the results of our audit work for 2015/16 including key issues and recommendations raised as a result of our observations.

We also provided the mandatory declarations required under auditing standards as part of this report.

Annual Audit Letter (October 2016)

This Annual Audit Letter provides a summary of the results of our audit for 2015/16.

Appendix 5: Audit fees

This appendix provides information on our final fees for the 2015/16 audit.

To ensure transparency about the extent of our fee relationship with the Authority we have summarised below the fees charged for the 2015/16 audit and certification fees.

External audit

Our planned fee for the 2015/16 audit of the Authority was £80,775 (2014/15: £107,700). This was a 24% reduction against the scale fees set by Public Sector Audit Appointments Limited.

However, we incurred additional costs due to:

— delays and issues with the Authority's working papers, which required additional resources. Significant areas of delay are loans and fixed assets. Key information was provided after our planned on-site visit despite early information request in January 2016 (see Appendix 4);

— additional work, which was not allowed for in our initial plan, namely the consideration of a formal objection received from a local elector.

Our final fee is still under discussion with senior Officers and will be subject to final determination by Public Sector Audit Appointments Limited.

Certification of grants and returns

Under our terms of engagement with Public Sector Audit Appointments Limited we undertake prescribed work in order to certify the Authority's housing benefit grant claim. This certification work is still on-going. The planned fee for this is £10,579 (2014/15: £14,650). The final fee will be confirmed through our reporting on the outcome of that work in January 2017.

Other services

We are currently undertaking work on the certification of the Pooling of Housing Capital Receipts return, which is outside of Public Sector Audit Appointments Limited's certification regime.

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