

Annual Audit Letter

Leicester, Leicestershire and Rutland Combined Fire Authority

Year ending 31 March 2019





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1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Leicestershire, Leicester and Rutland Combined Fire Authority (the Authority) for the year ended 31 March 2019. Although this letter is addressed to the Authority, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 27 September 2019 included our opinion that the financial statements:</p> <ul style="list-style-type: none">• give a true and fair view of the Authority's financial position as at 31 March 2019 and of its expenditure and income for the year then ended; and• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 27 September 2019 included our opinion that:</p> <ul style="list-style-type: none">• the other information in the Statement of Accounts is consistent with the audited financial statements.
Value for Money conclusion	<p>Our report concluded that we are satisfied that in all significant respects, the Authority has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.</p>
Reporting to the group auditor	<p>On 27 September 2019 we reported that your activity was below the threshold set by the NAO, meaning we were not required to review the Whole of Government Accounts return.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Authority.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Authority and whether they give a true and fair view of the Authority's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report, issued to the Authority on 27 September 2019, stated that, in our view, the financial statements give a true and fair view of the Authority's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Authority. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2019:

Financial statement materiality	Our financial statement materiality is based on 2% of gross operating expenditure at surplus / deficit on provision of services level	£1.130m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£0.034m

2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Authority's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Governance Committee within the Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
<p>Management override of controls Management at various levels within an organization are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	<p>We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> • accounting estimates impacting on amounts included in the financial statements; • consideration of identified significant transactions outside the normal course of business; and • journals recorded in the general ledger and other adjustments made in preparation of the financial statements. 	<p>Our audit work has not identified any evidence of the management override of controls.</p>

2. SIGNIFICANT FINDINGS (CONTINUED)

Significant risk

Valuation of property, plant and equipment, investment properties and assets held for sale

Identified risk

The Authority's accounts contain material balances and disclosures relating to its holding of property, plant and equipment, investment properties and assets held for sale, with the majority of land and building assets required to be carried at valuation. Due to high degree of estimation uncertainty associated with those held at valuation, we determined there was a significant risk in this area.

Our Response

We addressed the risk by considering the Authority's arrangements for ensuring that valuations were reasonable and we engaged our own expert to provide data to enable us to assess the reasonableness of the valuations provided by the Authority's valuer. We also assessed the competence, skills and experience of the valuer.

We also performed further audit procedures on individual assets to ensure that the basis and level of revaluation was appropriate.

Our Findings and Conclusion

Our work on Property, Plant and Equipment (PPE) identified a number of errors, which suggested a lack of understanding of the accounting treatment for fixed assets and are indicative of control issues and a lack of management checks in relation to the accounting for PPE.

The main issues identified were:

- Assets under construction had been incorrectly depreciated;
- Asset useful lives had not been correctly updated in the Fixed Asset Register in 2017/18 and this led to incorrect depreciation calculations being applied in 2018/19. The impact of this error was £107k. This is not material and has not been adjusted for this year, but it is important to make these calculations using the correct methodology in future;
- The values for individual classes of asset within PPE did not fully reconcile back to the Fixed Asset Register (FAR) or ledger although the overall total did agree. Further investigation by officers identified an asset that has been incorrectly classified as land and buildings when it should have been within Vehicles, Plant and Equipment. This has been correctly reflected in the financial statements but the FAR should be corrected so in future years all reconciliations fully balance;
- The revaluation increases recognised in the revaluation reserve and the revaluation decreases recognised in the surplus/deficit on the provision of services line were both overstated by £810k in note 15. This error occurred because the asset additions were not correctly accounted for in the revaluation reserve and had to be amended via a manual calculation. This has no impact on the overall balance in PPE but suggests a lack of checks to reconcile figures within the PPE note back to the revaluation reserve where the error was evident. This led to two further non material adjustments being identified and amended in note 24. These changes have been reflected in the final version of accounts.

Assistance needed to be provided to the fire finance team by officers from Leicester City Council in order to fully explore and resolve these issues.

Following the required amendments, we obtained the assurance required with no other significant issues arising we were required to highlight to you.

2. SIGNIFICANT FINDINGS (CONTINUED)

Significant Risk

Defined benefit liability valuation

Identified Risk

The financial statements contain material pension entries in respect of retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.

Our Response

We addressed the risk by discussing with key contacts any significant changes to the pension estimates. In addition to our standard programme of work in this area, we evaluated the management controls you have in place to assess the reasonableness of the figures provided by the Actuary and considered the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally.

We reviewed the appropriateness of the key assumptions included within the valuations, compared them to expected ranges and reviewed the methodology applied in the valuation. We also considered the adequacy of the disclosures in the financial statements.

Our Findings and Conclusion

There are two sets of actuarial figures for the Authority, one in relation to the local government pension scheme and another in relation to firefighters. We reviewed the assumptions used by the actuary for each scheme and found these to be reasonable and within the ranges expected.

Although the actuarial calculations were reasonable, we identified that the draft financial statements did not correctly reflect the pensions information in the financial statements. It was apparent that there were material errors in accounting for pensions which were errors of principle, and a number of important disclosures had not been included or were not clearly set out. Initially, we were unable to establish whether these errors had an impact on the bottom line position of the Authority, as the pensions accounting entries were not well documented and were difficult to follow. It was also evident that the 2017/18 financial statements included material errors which would also require correction as a prior period adjustment.

Although the fire service finance team was able to correct the missing disclosures in the notes to the accounts, they did not demonstrate an understanding of how the pension figures should be reflected in the financial statements. Consequently, on 24 June 2019 we escalated our concerns on this and other issues.

Assistance was provided to the fire finance team by officers from Leicester City Council and additional support in relation to pensions accounting was obtained from another local fire authority. The revised financial statements provided to us on 25 July 2019 included the corrected pensions position. Adjustments in relation to pensions accounting relating to these issues amounted to in the region of £8m in the Comprehensive Income and Expenditure Statement in both 2017/18 and 2018/19. However, there was no impact on the bottom line financial position of the Authority and the revised working papers provided by officers gave the assurance for this which had previously been missing.

An additional material amendment of £18.6m was made in the 2018/19 disclosures relating to the impact of the McCloud legal case on pension liabilities. This adjustment resulted from a national issue and was not the result of error by the Authority.

Following the amendments made, we obtained the assurance required, with no other significant issues arising we were required to highlight to you.

2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls.

We identified 3 high risk deficiencies in internal control as part of our audit and one medium priority recommendation.

There were no Prior Year recommendation to follow up (Note: Mazars were not the auditors for the Authority in 2017/18)

Description of deficiency

Preparation of the Financial Statements (Level 1 – high priority)

The draft financial statements that were presented for audit on 31 May 2019 contained material errors and the working papers presented to support key aspects of the financial statements were inadequate.

There was evidence that the financial statements had not been through a satisfactory quality assurance process. The statements included a number of clear errors and omissions. These included:

- Clear problems on the face of the Comprehensive Income and Expenditure Statement that had not been considered;
- Missing and duplicated information; and
- The omission of a key note in relation to the 2018/19 Firefighters Pension Scheme and a number of other inconsistencies and lack of clarity in the pension notes.

In addition to this, the working papers supporting the financial statements did not agree to the ledger, and note 14, which is meant to provide an analysis of income and expenditure could not be related to the content of the Comprehensive Income and Expenditure Statement.

We started our audit on 3 June 2019, but on 11 June 2019 we were provided with a revised set of financial statements, although these did not address all of the issues identified. There was limited explanation of the changes.

The working papers provided for the final accounts audit were not in line with the working paper protocol we had set out for officers. Some working papers were not provided while others were difficult to follow or not revised following amendment to the original accounts. The main internal control issue was the difficulty in mapping the ledger to the financial statements with some income being found in reserves adjustments rather than on an income code and some adjustments not being made in the ledger, but put through the financial statements as manual adjustments which were not clearly documented or supported. We found that there was a lack of responsiveness to the issues we raised in the first two weeks of our audit which created significant difficulties and contributed to overruns of the time taken to carry out our work.

The errors identified above and the provision of a revised set of financial statements eight days into the audit, indicated a lack of control of the accounts closedown process and the financial statements did not appear to have been subject to adequate levels of management checks and review.

2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations (continued)

Potential effects

The Treasurer and the Authority do not have the required level of assurance or confidence in the financial statements being prepared. The financial statements contain material errors that need to be corrected. Additional work needs to be carried out by officers to address the deficiencies and respond to audit queries, and there are resultant audit time overruns and additional audit fees. The audit timetable required by the Accounts and Audit Regulations 2015 can not be met.

Recommendation

We recommended that the Authority fully reviews its processes for preparing the financial statements and makes improvements in its arrangements to prevent a recurrence of the problems with the 2018/19 financial statements in future years.

Key issues to address should include:

- A review of any gaps in the skills and competencies required in the production of the financial statements, and the provision of external support where needed, particularly in complex technical areas;
- Improvements in the level of supervision and review of the production of the draft financial statements;
- Improvements in the arrangements for compiling working papers and providing evidence to show how the figures reflected in the financial statements have been derived; this should include a clear mapping of the trial balance to the financial statements, ensuring that all transactions are properly reflected in the ledger and ensuring that any manual adjustments are properly documented and supported;
- Implementation of quality assurance processes to ensure the risk of material error in the draft financial statements is minimised.

Management response

The Authority will be working to review the process currently in place to compile the Statement of Accounts, including assessing skills gaps and ensuring the correct quality assurance process.

2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations (continued)

Description of Deficiency	Accounting for Property Plant and Equipment (Level 1 – high priority) The Authority has not correctly accounted for all aspects of property, plant and equipment (PPE). The PPE note did not correctly reconcile to the Fixed Asset Register (FAR) by asset category, the depreciation charge was incorrectly calculated as a result of failing to update asset useful lives correctly, and incorrectly applied to assets under construction and the revaluation figures posted to the note were overstated as a result of additions not being posted correctly to the revaluation reserve.
Potential effects	Potential for material misstatements in accounting for PPE.
Recommendation	We recommend that depreciation is not applied to assets under construction, the useful lives of assets are correctly input to the fixed asset register and checked, assets are correctly reflected in the correct category of the asset register so that it can be reconciled to the PPE note and additions are treated correctly in the revaluation reserve in future years. Management understanding and internal control checks on PPE accounting entries need to be improved.
Management response	The Authority will review the current process for completing the PPE entries, along with incorporating adequate quality assurance going forward.

2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations (continued)

Description of Deficiency	Accounting for Pensions (Level 1 – high priority) The Authority has not correctly accounted for all aspects pensions accounting. It was apparent that there were material errors in accounting for pensions which were errors of principle, and a number of important disclosures had not been included or were not clearly set out. Although the fire service finance team was able to correct the missing disclosures in the notes to the accounts, they did not demonstrate an understanding of how the pension figures should be reflected in the financial statements. Assistance was provided to the fire finance team by officers from Leicester City Council and additional support in relation to pensions accounting was obtained from another local fire authority. The revised financial statements provided to us on 25 July 2019 included the corrected pensions position. Adjustments in relation to pensions accounting relating to these issues amounted to in the region of £8m in the Comprehensive Income and Expenditure Statement in both 2017/18 and 2018/19. However, there was no impact on the bottom line financial position of the Authority and the revised working papers provided by officers gave the assurance for this which had previously been missing.
Potential effects	Potential for material misstatements in accounting for pensions.
Recommendation	We recommend that officers ensure that pensions disclosures are properly reflected in the financial statements in future years.
Management response	The Authority will review the current process for compiling the pension entries and notes, along with incorporating a better quality assurance process.

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

Our approach to Value for Money

We are required to consider whether the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- informed decision-making;
- sustainable resource deployment; and
- working with partners and other third parties.

Our auditor's report, issued to the Authority on 27 September 2019, stated that, in all significant respects, the Authority put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2019.

Delivery of Budgets and Financial Resilience Significant Risk

The continual pressures on public sector finances are well documented and led to another challenging budget setting process for 2018/19. The Authority set a balanced budget on 7 February 2018.

The month 8 forecast showed that the Authority may deliver a £34k overspend against its revenue budget and a £232k underspend on capital. The revenue deficit is derived from an increase in expenditure of £298k and an increase in income of £264k. As the planned overspend was small no action was being proposed by the Authority at that stage, although ongoing monitoring would occur until the year end.

There will be significant changes in Local Government finances over the next few years, which will culminate in a major change in the way Local Government is financed from 2020/21 onwards. These include the 2019 Spending Review, the Fair Funding Review and the introduction of 75% local retention of business rates (up from 50% retention). At that moment the Authority did not know if they would gain or lose under these changes and the ongoing funding position was very uncertain from 2020/21.

Another potential pressure was the ongoing firefighters pay award which was budgeted at 2%. Any increases to this award (which potentially could go up to 15% as agreed in Scotland) would impact significantly on the Authority. It was assumed any future increases would be met by the Government. If not each 1% increase would cost the Authority £200k per annum and would not be affordable under the current budget plans.

As a result, the need for savings (or income generation) would continue to have a significant impact on the Authority's ongoing financial resilience and reduce the burden on the need to borrow or utilise reserves to balance any future budget deficits.

Value for Money Arrangements Affected: Deploying resources in a sustainable manner

Our Response

We critically reviewed whether the Authority had arrangements in place to ensure financial resilience, specifically that the Medium Term Financial Plan (MTFP) had duly taken into consideration the latest available information on factors such as, funding reductions, business rate reform, fair funding, salary and general inflation, demand pressures and restructuring costs. We also reviewed the Authority's progress against planned savings in 2018/19 and the utilisation of reserves in the outturn report compared to the original budget. We also reviewed the findings from the recent HMICFRS inspection review.

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3. VALUE FOR MONEY CONCLUSION

Our findings

2018/19 Outturn

The outturn presented to the Authority on 19 June 2019 reported a net revenue budget under-spend of £0.609m on services in 2018/19 against the adjusted budget.

Medium Term Financial Plan (MTFP)

The Authority's MTFP was approved by the Authority on 6 February 2019 providing indicative financial projections through to 2021/22. The plan has been developed by looking to constrain expenditure while identifying efficiencies and increasing income. The financial position beyond 2019/20 is largely unknown but the Authority have identified the two key risks they face financially as being pay (the settlement for 2018/19 has not yet been finalised or agreed) and expected increases in the employers contributions to the Firefighters Pension Scheme. The CFA have budgeted for a 1% pay rise so any changes above this will impact on the budget. It is anticipated any additional 1% increase will cost the authority an additional £0.2m and will have to be funded from additional savings. The MTFP also identifies that setting council tax at the third lowest level in the country reduces the Authority's available income by £3.8m per annum (when compared to the average increase across the country). The MTFP shows that earlier years' budgets included an anticipated saving of £250,000 in 2018/19, rising to £450,000 by 2019/20, from efficiencies in management, support staff, premises and fleet. The target has been all but achieved, with a further £87,000 still required for 2019/20. It is expected that this will be delivered by means of a number of minor savings. Further work is required to firm up specific saving plans for 2020/21 and beyond and the outcome of the Fair Funding review will help inform the Authority's plans. As with any other Authority the ongoing monitoring of budgets and planned savings is crucial in ensuring the level of reserves are maintained and the MTFP is achieved, this is especially important given the fact that the budget from 2019/20 onwards is sensitive to small changes in pay and pension costs. At the time of reporting the future funding position remains uncertain making it very difficult for the Authority to take a medium term view.

General Reserves

The Authority's planned use of general reserves ensures the MTFP remains in balance. The Authority recognises the key issue is the management of general reserves to a level that ensures it remains financially resilient and able to deliver sustainable services, whilst insulating it against significant financial risk. Without ongoing monitoring and action, the Authority's reserves may deteriorate. Over the three years to 2021/22, the minimum level of general fund reserves is due to remain at £2.0m each year to cover any unexpected expenditure and it is over this period, we judge it most relevant to base our Value for Money Conclusion on. The general fund and earmarked reserves as at the end of March 2019 are £2.612m and £12.448m respectively. The MTFP does not show the planned reserve balances from 2019/20 although the MTFP suggests a balanced budget is set without the need to utilise reserves until 2021/2022. As part of a MTFP we would expect to see the utilisation of reserves shown for the next few years rather than just concentrate on the year ahead.

At the time of reporting the future funding position remains uncertain making it very difficult for the Authority to take a medium term view. However, the Authority's reserves position means it is relatively well placed to manage any immediate challenges.

HMICFRS inspection

The Authority has been subject to an inspection by HM Inspectorate of Constabulary and Fire and Rescue Services (HMICFRS). The inspection report was published on 20 June 2019 and the ratings were:

- Effectiveness – Requires Improvement;
- Efficiency – Requires Improvement; and
- People – Requires Improvement.

The Authority is developing an action plan, focusing its response on the aspects of the inspection requiring improvement. Clearly, implementing the action plan will be a key area of focus for the Authority in the coming year.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of group audit reporting requirements	Below review threshold
Other information published alongside the audited financial statements	Consistent

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Authority's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the Whole of Government Accounts (WGA) Assurance Statement in respect of its consolidation data. On 27 September 2019 we reported that your activity was below the threshold set by the NAO, meaning we were not required to review the WGA return.

Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Authority. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.

5. OUR FEES

Fees for work as the Authority's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the Corporate Governance Committee in March 2019.

Having completed our work for the 2018/19 financial year, we can confirm our final fees are as follows:

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£22,520	£30,520*

* subject to agreement by the PSAA. The additional fee of £8,000 plus VAT was reported to the Authority in our Audit Completion report and agreed by the Authority at its meeting on the 27th September 2019. It relates to the additional time spent on the audit due to the difficulties encountered as well as in relation to the McCloud/GMP pension changes.

Fees for other work

We confirm that we have not undertaken any non-audit services for the Authority in the year.

6. FORWARD LOOK

Next year's audit and how we will work with the Authority

We will focus our work on the risks that your challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money.

In the coming year we will continue to:

- liaise with the Authority's Internal Auditors to minimise duplication of work;
- Attend Corporate Governance meetings and present Audit Progress Reports including updates on regional and national developments; and
- host events for officers such as our Local Government Accounts workshop.

We will meet officers to identify any learning from the 2018/19 audit and will continue to share our insights from across local government and relevant knowledge from the wider public and private sector.

In terms of the technical challenges that officers face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise.

The Authority has taken a positive and constructive approach to our audit and we wish to thank Members, the Corporate Governance Committee and officers for their support and co-operation during our audit.

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