

# **The** Annual Audit Letter for Dudley Metropolitan Council

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Year ended 31 March 2019

28 August 2019



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# Executive Summary

## Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Dudley Metropolitan Borough Council (the Council) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit and Standards Committee as those charged with governance in our Audit Findings Report on 29 July 2019.

## Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

## Our work

<b>Materiality</b>	We determined materiality for the audit of the Council's financial statements to be £12,000,000, which is 1.8% of the Council's gross operating expenses in 2017/18 after discounting the effect of the revaluation gain on housing stock.
<b>Financial Statements opinion</b>	We gave an unqualified opinion on the Council's financial statements on 31 July 2019. The accounts were prepared to a good standard together with appropriate working papers available from the start of the audit. The finance team responded promptly and efficiently to our queries during the course of the audit. We identified three adjustments to the financial statements that have resulted in changes to the Statement of Comprehensive Income and Expenditure and Balance Sheet. These are set out in more detail later but did not impact on useable reserves.
<b>Whole of Government Accounts (WGA)</b>	We completed our work on the Council's consolidation return in August 2019 following guidance issued by the NAO. There were no issues to report.
<b>Use of statutory powers</b>	We did not identify any matters which required us to exercise our additional statutory powers.
<b>Value for Money arrangements</b>	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 31 July 2019. The better than expected 2018/19 financial outturn has improved the Council's financial resilience, but it still faces a significant financial challenge to achieve financial sustainability.
<b>Certificate</b>	We certify that we have completed the audit of the accounts of the Council in accordance with the requirements of the Code of Audit Practice.
<b>Certification of Grants</b>	We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions, Housing Capital Receipts Return and Teachers Pensions Return. Our work on these claims is not yet complete and will report the results of this work to the Audit and Standards Committee separately.

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# Executive Summary

## Key messages

### Financial statements

Draft accounts were required to be presented for audit by the end of May and our audit completed by the end of July. It is pleasing to report that the Council's finance team coped well with this timetable. The accounts were presented for audit promptly and well supported with working papers. The finance team were very supportive throughout our audit.

We identified three adjustments to the financial statements that resulted in changes to the Statement of Comprehensive Income and Expenditure and balance sheet. These are set out in more detail later but did not impact on useable reserves. We also identified some disclosure changes that were included in the final version of the financial statements.

### Value for money conclusion

We are required to give a conclusion on whether the Council has proper arrangements in place to secure value for money in the use of its resources. Our work focused on:

- the Council's medium term financial strategy; and
- the Ofsted inspection of children's services

The Council's 2018/19 outturn position was a favourable variance of £3.4 million, but resulted in a decrease in the General Fund working balance to £22.6 million. The better than expected 2018/19 outturn position improved the financial resilience of the Council. There are however continuing risks and uncertainties that threaten the Council's overall financial position.

We considered the savings plans in place, increases in unfunded spending and the forecast reduction in General Fund balances. We are satisfied that the overall forecast financial position is realistic. The planned use of balances buys the Council time to deliver recurrent savings, and it is vital that income growth is achieved to close the financial gap. In considering the 2020/21 budget options the Council needs to consider carefully the level of Council Tax increase that will maintain its financial sustainability in the medium term.

In 2016 Ofsted concluded that there were serious and widespread failures in the services provided to children and young people in Dudley. Overall they rated the Council's service as inadequate.

The Ofsted full inspection report published in November 2018 noted significant improvements in services for safeguarding children and assessed the service as "requires improvement to be good". Ofsted also highlighted areas for improvement.

We concluded that the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2018.

### Working with the Council

We are really pleased to have worked with you over the past year. We have sought to work alongside the Council, and help it pursue its objectives. Examples include working with the finance team to provide an earlier audit opinion freeing up your staff to do other things, liaising early with officers on the new accounting issues for 2018/19, providing training to officers and sharing insights, thought leadership and good practice.

We would like to record our appreciation for the excellent assistance and co-operation provided to us during our audit by the Council's staff.

**Grant Thornton UK LLP**  
August 2019

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# Audit of the Accounts

## Our audit approach

### Materiality

In our audit of the Council's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Council's accounts to be £12,000,000, which is 1.8% of the Council's gross operating expenses in 2017/18 after discounting the effect of the revaluation gain on housing stock. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We also set a lower level of specific materiality at £100,000 for senior officer remuneration.

We also set a threshold of £800,000, above which we reported errors to the Audit and Standards Committee in our Audit Findings Report.

### The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the Statement of Accounts and the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the financial statements included in the Statement of Accounts on which we give our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach is based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

# Audit of the Accounts

## Significant Audit Risks

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Management override of controls</b></p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>Our audit work included:</p> <ul style="list-style-type: none"><li>• gaining an understanding of the accounting estimates, judgements applied and decisions made by management and considering their reasonableness</li><li>• obtaining a full listing of journal entries, identifying and testing unusual journal entries for appropriateness</li><li>• evaluating the rationale for any changes in accounting policies or significant unusual transactions.</li></ul>	<p>Our audit work did not identify any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal entries did not identify any significant issues.</p>

# Audit of the Accounts

## Significant Audit Risks (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Valuation of land and buildings</b></p> <p>The Council re-values its land and buildings on a rolling five year programme to ensure that the carrying value is not materially different from fair value. It also carries out a desk top exercise each year to ensure that those assets not revalued in that year are not materially misstated. This is a significant estimate by management in the financial statements as land and buildings account for around 75% by value of the Council's assets.</p> <p>We identified the valuation of land and buildings valuations as a risk requiring special audit consideration.</p>	<p>Our audit work included, but was not restricted to:</p> <ul style="list-style-type: none"> <li>• assessing management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work;</li> <li>• evaluating the competence, capabilities and objectivity of the Council's management experts;</li> <li>• assessing and challenging the information used by the valuer to obtain sufficient assurance that ensure it was robust and consistent with our understanding;</li> <li>• discussing with the valuer the basis on which the valuation was carried out, including challenging the key assumptions used; and</li> <li>• evaluating the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value.</li> </ul>	<p>Housing stock was valued in the draft accounts as at the 1<sup>st</sup> April 2018. The valuation should have been as at the 31<sup>st</sup> March 2019. This valuation was the 1<sup>st</sup> April 2017 valuation updated by indices.</p> <p>We challenged how management obtained assurance that the valuation was appropriate for the 31<sup>st</sup> March 2019. As a result the Council restated both the opening and closing housing stock valuation. The value of housing stock as at 31 March 2019 increased by £15.1 million.</p>

# Audit of the Accounts

## Significant Audit Risks (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Valuation of pension fund net liability</b></p> <p>The Council's pension fund net liability, as reflected in its balance sheet, is a significant estimate in the financial statements. The net liability accounts for 30% of the Council's liabilities.</p> <p>We therefore identified the valuation of the pension fund net liability as a risk requiring special audit consideration.</p>	<p>Our audit work included, but was not restricted to:</p> <ul style="list-style-type: none"> <li>gaining an understanding of the processes and the controls put in place by management to ensure that the net pension fund liability was not materially misstated and evaluating the design of the associated controls;</li> <li>evaluating the competence, capabilities and objectivity of the Council's actuary who carried out the pension fund valuation;</li> <li>gaining an understanding of the basis on which the valuation was carried out, including evaluating the reasonableness of the significant assumptions used by management and their actuary;</li> <li>confirming the consistency of the pension fund gross asset and gross liability figures and associated disclosures in the notes to the financial statements with the actuarial report from the actuary;</li> <li>obtaining and evaluating the results of work performed by the Pension Fund's external auditor which was of relevance to the valuation of the net pension liability; and</li> <li>performing analytical procedures in respect of the gross pension fund assets and liabilities.</li> </ul>	<p>At the time the accounts were prepared there was significant uncertainty about whether the Government would be granted leave to appeal to the Supreme Court following the Court of Appeals decision in the McCloud case concerning age discrimination in Firefighters' pension schemes.</p> <p>In late June the Government was refused leave to appeal, which meant that the impact on local authorities pension liabilities became more certain. We asked the Council to commission an updated actuary report to consider the impact of the McCloud court ruling on its pensions liabilities. The Council agreed and as a result the net pension liability increased by £15.8 million. The accounts were restated for this change. This had no impact on the Council's useable reserves.</p> <p>In October 2018, the High Court ruled that defined benefit pension schemes must remove any discriminatory effect that guaranteed minimum pension entitlements (GMPs) have had on members benefits. GMPs must be equalised between men and women and that past underpayments must be corrected. Actuaries have taken differing approaches to this issue. We have concluded that there was a low risk of material estimation uncertainty for GMPs in the Council's revised pension liability.</p>



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# Audit of the Accounts

## **Audit opinion**

We gave an unqualified opinion on the Council's financial statements on 31 July 2019.

## **Preparation of the accounts**

The Council presented us with a good set of draft accounts in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

## **Issues arising from the audit of the accounts**

We reported the key issues from our audit to the Council's Audit and Standards Committee on 29 July 2019.

## **Annual Governance Statement and Narrative Report**

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

The narrative report was prepared in line with the CIPFA Code and relevant supporting guidance. Following amendments to the Annual Governance Statement we also concluded that this conformed to guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

## **Whole of Government Accounts (WGA)**

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement which did not identify any issues for the group auditor to consider.

## **Certificate of closure of the audit**

We are also required to certify that we have completed the audit of the accounts of Dudley Metropolitan Borough Council in accordance with the requirements of the Code of Audit Practice.

We issued our certificate of audit completion on the 12 August 2019 following the finalisation of our work on the Council's Whole of Government Accounts.

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# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

*In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

## Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work. In arriving at our conclusion, our main considerations were:

- the Council's medium term financial strategy; and
- the Ofsted inspection of children's services

Our key findings were as follows

The better than expected 2018/19 financial outturn has improved the Council's financial resilience, but it still faces a significant financial challenge to achieve financial sustainability. The planned use of balances buys the Council time to deliver recurrent savings and it is vital that income growth is achieved to close the financial gap.

In 2016 Ofsted concluded that there were serious and widespread failures in the services provided to children and young people in Dudley. Overall they rated the Council's service as inadequate. The Ofsted full inspection report published in November 2018 noted significant improvements in services for safeguarding children and assessed the service as "requires improvement to be good". Ofsted highlighted the areas for improvement

As part of our Audit Findings report agreed with the Council in July 2019, we agreed recommendations to address our findings.

The key risks we identified and the work we performed are set out overleaf.

## Overall Value for Money conclusion

We are satisfied that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

# Value for Money conclusion

Risks identified in our audit plan and how we responded	Findings	Conclusions
<p><b>Medium Term Financial Strategy</b></p> <p>The October 2018 update for Cabinet of the Medium Term Financial Strategy showed that during the 2021/22 financial year, the General Fund working balances will be fully depleted. Our level of concern increased as the Council had not identified and agreed sufficient savings plans to prevent its forecast General Fund balance reducing to this unacceptably low level.</p> <p>The Council needed to demonstrate that it has a realistic medium term financial plan that will deliver a balanced and sustainable financial position in an environment of reduced funding.</p> <p><b>Our response</b></p> <p>We said we would review the plans the Council has to identify and agree the required savings plans.</p>	<p>The Council's 2018/19 outturn position was an underspend of £3.4 million against the original budget resulting in smaller decrease in the General Fund working balance than expected (a decrease of £4 million to £22.6 million at 31 March 2019). The Council's earmarked General Fund reserves (excluding schools and Public Health) also decreased in the year by £0.9 million to £23.4 million.</p> <p>The Council's Medium Term Financial Strategy was regularly updated throughout the year, in line with the annual planning process. The updates included expected and known changes to Government funding arrangements, spending pressures and identified savings plans.</p> <p>Throughout this update process the Chief Officer (Finance and Legal) made realistic assessments of proposed savings plans and only included those where he had reasonable assurance that they will be delivered.</p> <p>The Council's medium term financial outlook has improved slightly over the last 12 months. However significant risks remain in relation to the financial position and these have been consistently and clearly communicated to Members by the Chief Officer (Finance and Legal).</p> <p>At the time of setting the 2019/20 budget, the Council did not identify and agree a strategy to prevent its forecast General Fund reducing to an unacceptably low level by the end of 2021/22. The Council's earmarked and un-earmarked General Fund reserves remain much lower than most similar councils. In addition there are significant risks to these forecasts that mean that the financial position may become unsustainable at an earlier date.</p>	<p>The better than expected 2018/19 outturn position reduced the planned use of balances. There are however continuing significant risks and uncertainties that threaten the Council's overall financial stability.</p> <p>We considered whether there are appropriate arrangements in place to plan finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions. We specifically considered:</p> <ul style="list-style-type: none"> <li>• savings planning;</li> <li>• increases in unfunded spending; and</li> <li>• The forecast level of General Fund balances to the end of 2021/22.</li> </ul> <p>We are satisfied that the forecast position is a realistic assessment of the financial challenge. We concluded from our review of a sample of 2019/20 savings scheme that there is sufficient prudence in the recognition of cash releasing savings.</p> <p>However, the continued planned use of balances to close the financial gap only buys the Council time in which to develop a sustainable financial strategy. In our view it is vital that further-income growth is achieved to close the financial gap and ensure that the finances of the Council are sustainable in the medium term.</p> <p>In considering the 2020/21 budget options the Council needs to give attention to ways that it can grow its income base including the level of Council Tax increases. The Council has a comparatively low level of Council Tax. It is currently the lowest of the West Midlands Metropolitan Districts, and the second lowest of all Metropolitan District Councils. Whereas the level of Council Tax is a matter for the Council, it needs to consider carefully whether its major source of income is sufficient to maintain financial sustainability in both the short and medium term.</p> <p>We have concluded that notwithstanding the uncertainties in the Council's medium term financial outlook the Council has proper arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions</p>

# Value for Money conclusion (continued)

Risks identified in our audit plan and how we responded	Findings	Conclusions
<p><b>Ofsted inspection of children's services</b></p> <p>Ofsted issued a report on the Council's children's services in 2015/16 which rated these services as 'inadequate' and the Council was subject to regular follow up reviews. A full follow up inspection at the end of 2018 by Ofsted confirmed that adequate arrangements are now in place but highlighted areas where more progress was necessary. Children's Services were rated as 'requires improvement to be good'.</p> <p><b>Our response</b></p> <p>We said we would review reports from Ofsted and take these into account in forming our conclusion</p>	<p>Since issuing its 2016 report Ofsted published the outcome of seven monitoring inspections focussing on different aspects of service delivery. These highlighted positive progress and areas where further improvement was required.</p> <p>Ofsted carried out a full inspection in October and November 2018. The overall assessment score given by Ofsted in their report published in November was "requires improvement to be good" and two out of the three themes "(leadership" and "children in and leaving care") were assessed as "good". The third theme "help and protection" was rated as "requires improvement". Ofsted reported that the Council had made significant progress since its last inspection in 2016. It commented that there had been effective work by senior leaders and staff and investment and commitment by Members and that this had lead to improved responses to children and families which meant outcomes for children and their families were much better.</p> <p>Ofsted praised the Council's "recognition of the importance of preventative services and the considerable joint work with partners" which has meant that "children and families benefit from an effective early help service". Ofsted commented that if children's needs escalate in Dudley, they receive a considered and timely response from social care and that risk to children is recognised and effective action is taken to minimise that risk. Areas of service identified as inadequate in the last inspection were recognised as having "been turned around and now deliver better quality and more focused and child-centred practice". In particular, this has resulted in "good-quality planning for children in care and better long-term outcomes for them". Ofsted reported that children who come into care have plans made to safely return them home or to ensure that there are good alternative long-term caring arrangements made for.</p> <p>The report highlighted remaining issues in the speed and quality of the assessment process for children. The main issue concern recruitment, especially at social work manager grade. Staff turnover is decreasing but is still around a third of social work staff are agency, although there are plans in place to reduce this significantly. Ofsted said this was having a detrimental effect especially for the assessment teams. Ofsted found that plans for children in need should be clearer in terms of actions needed and timeframes and some young people have remained in care longer than they should.</p> <p>The Council has drawn up a comprehensive medium term improvement plan to build on the review and an accompanying action plan. This plan includes links to the Dudley plan, governance arrangements through to Cabinet, a balanced scorecard of KPIs and an action plan. In the autumn 2019, a three year strategic plan will be agreed with partners.</p>	<p>We reviewed Ofsted's monitoring visit letters and the full inspection report published in November 2018 as well as discussing the issues contained within the reports with senior Officers. We took these into account in forming our conclusion.</p> <p>The full inspection report reflects the significant progress that has been made by the Council in responding to the issues raised by Ofsted in their inspection in 2016. The report also highlights where further improvements are still required.</p> <p>We have concluded that, notwithstanding the areas highlighted by Ofsted for further improvement in children's services, the Council has proper arrangements for understanding and using appropriate and reliable financial and performance information including, where relevant, information from regulatory/monitoring bodies to support informed decision making and performance management.</p>

# A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

## Reports issued

Report	Date issued
Audit Plan	February 2019
Audit Findings Report	July 2019
Annual Audit Letter	August 2019

## Fees

	2018/19 Planned £	2018/19 Actual £	2016/17 Actual £
Statutory audit (subject to audit fee variation)	103,743	112,743	134,435

Fees for other services	Planned £
<b>Audit related services:</b>	
Housing capital receipts 2018/19	3,500
Housing benefits 2018/19	16,000
Teachers pensions return 2018/19	5,900
Teachers pensions return 2017/18	5,900
<b>Total</b>	<b>£31,300</b>

## Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £103,743 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

Area	Reason	Fee proposed £
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	3,000
Pensions – IAS 19 PPE valuations	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 and PPE valuations needs to improve across all local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 and PPE valuations this year to reflect this.	6,000
<b>Total</b>		<b>£9,000</b>

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all non-audit services which were identified. We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place. The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.

