Audit management letter

for the year ended 31 March 2016 for

Cobtree Manor Estate

Prepared by:	Allan Hickie, Audit Partner
Date of issue:	31 January 2017

1. Introduction

Appendices

1. Introduction

This report has been prepared for Maidstone Borough Council, which acts as the corporate trustee of Cobtree Manor Estate ("Cobtree"), to bring attention to those charged with governance various matters arising from the audit of the charity for the year ended 31 March 2016.

Our audit procedures, which have been designed to enable us to express an opinion on the financial statements, have included an examination of the transactions and controls thereon of the charity.

The work we have done was not primarily directed towards identifying weaknesses in the charity's accounting systems, other than those that would affect our audit opinion, nor to the detection of fraud. We have, however, designed our audit procedures in such a way that we felt would increase our chance of detecting any fraud.

We have included in this report only those matters that have come to our attention as a result of our normal audit procedures and, consequently, our comments should not be regarded as a comprehensive record of all weaknesses that may exist or improvements that could be made.

This report is to be regarded as confidential to the corporate trustee and is intended only for use by them, and their finance staff. No responsibility is accepted to any other person in respect of the whole or part of its contents. Before this report, or any part of it, is disclosed to a third party our written consent must be obtained.

The report is designed to include useful recommendations that may help improve performance and avoid weaknesses that could result in material loss to the charity or misstatement of the financial statements and other financial data.

Roles and Responsibilities

The corporate trustee is responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the corporate trustee confirms that our understanding of all of the matters referred to in this report are appropriate, having regard to their knowledge of the particular circumstances.

2. Overview

Audit Status and overall opinion

We set out below the current status of the audit and our timetable to completion.

We have substantially completed our work, and intend to issue an unmodified audit opinion, subject to the corporate trustee approving the financial statements and any other minor outstanding items listed below being received and/or completed.

The follow matters are outstanding at the date of this report:

- Final review and approval by you of the final financial statements;
- Agreement of the final financial statements, including the Trustees' Annual Report, to the latest draft;
- Post balance sheet events review to the date of signing the financial statements, including review of latest minutes and management accounts;
- Receipt of signed letter of audit representations.

2. Overview

Independence and ethical standards

We have not identified any potential threats to our independence as auditors. Please see Section 3 for further details.

Audit scope and objectives

We set out the scope and objectives of our audit. See Section 4.

Overall audit strategy

We set out our overall audit approach. See Section 5.

Key audit and accounting issues

We have obtained sufficient, appropriate audit evidence for the significant issues and risks identified during our audit.

During our audit we found no instances of fraud.

Recommendations

We are required to report to you on the significant deficiencies we found in internal controls during the course of our audit, along with any other deficiencies identified.

2. Overview

Misstatements and adjustments to the accounts

It is considered good practice to inform you of any material misstatements within the financial statements presented for audit that have been discovered during the audit. A material misstatement is one where the auditors believe that the misstatement is such as to affect the reader's understanding of the accounts. Materiality is considered in relation to the value of the misstatement and also its context and nature.

The adjustments agreed with you during the course of our audit are shown in Appendix I.

It is generally not practicable to make accounts completely accurate because judgements need to be made and it is difficult to obtain 100% of information about all transactions. Our role is to ensure that deviations from complete accuracy are not material to the reader of the accounts. During the course of our audit we did not identify any unadjusted audit differences.

Going concern

The corporate trustee needs to give consideration to the level of reserves maintained, and consider going concern for the period up to at least 31 January 2017, being an estimate of 12 months from the anticipated date of approval of the accounts, and ensure they agree with the assessment. The corporate trustee has confirmed that the financial statements should be prepared on a going concern basis on the grounds that current and future sources of funding or support will be more than adequate for the charity's needs. Our review supports the going concern status of the charity.

Thanks

We would like to take this opportunity to thank Maidstone Borough Council for the assistance afforded to us during the course of the audit.

3. Independence

Under current UK Ethical Standards we are required as auditors to confirm our independence to “those charged with governance” i.e. the corporate trustee.

Our internal procedures are designed to ensure that all partners and professional staff are aware of relationships that may be considered to bear on our objectivity and independence as auditors.

The procedures require that audit engagement partners are made aware of any matters which may reasonably be thought to bear on the firm’s independence and the objectivity of the audit engagement partner and the audit staff. This document considers such matters in the context of our audit for the year ended 31 March 2016.

In addition to performing the statutory audit, we also provide the following non-audit services:

Service	Possible threat	Safeguards
Preparation of the statutory financial statements from your underlying records and trial balance	Self-review	The process is largely a mechanical one, taking your financial results and putting them into statutory accounts which comply with the relevant legislation and financial reporting standards. All adjustments identified will be discussed with finance staff at Maidstone Borough Council (the corporate trustee), who are qualified accountants, and will be agree with them. We can rely on the
VAT advice	Self-review	The VAT advice is provided by our tax partner, Brian Carey, who has no involvement in the audit process.

4. Audit scope and objectives

Our statutory audit of the financial statements is carried out in accordance with International Standards on Auditing (UK and Ireland) of the statutory financial statements, with the aim of forming an opinion whether:

- The financial statements give a true and fair view of the state of the charity's affairs as at 31 March 2016 and of the result for the year then ended.
- The financial statements have been properly prepared in accordance with UK GAAP.
- The financial statements have been prepared in accordance with the requirements of the Charity SORP.
- The information given in the Trustees' Report for the financial year is consistent with the financial statements.

We also report on whether:

- The charity company has kept adequate accounting records.
- The financial statements are in agreement with the accounting records and returns.
- Other information contained in the annual report is not consistent with the audited financial statements.
- Certain disclosures of trustees' remuneration specified by law are not made.
- We have not received all the information and explanations we require for our audit.

5. Overall audit strategy

Risk-based audit

We performed a risk-based audit, focussing our work on key audit areas. We began by developing an understanding of the charity's activities and the specific risks it faces. We held an initial planning meeting with key management and finance staff to ascertain management's own view of potential audit risk, and to gain an understanding of the activities. We have also developed an in depth understanding of the accounting systems and controls so that we may ensure their adequacy as a basis for the preparation of the financial statements, and that proper accounting records have been maintained.

Our audit procedures were carried out, and then we ensured the presentation and disclosure in the accounts meet all the necessary requirements.

Significant risks

As part of our audit procedures we are required to consider the significant risks that require special audit attention.

Auditing Standards require us to consider:

- Whether there is a risk of fraud;
- Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;
- The complexity of transactions;
- Whether the risk involves significant transactions with related parties;
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

5. Overall audit strategy

The identified significant audit risks were communicated to you in our audit planning report issued before our main fieldwork began. We now note the work performed and conclusions drawn on the following pages:

Significant risk	**Explanation of the risk**	**Audit work performed**	**Conclusion**
Revenue recognition (mandatory risk)	The auditor's responsibility is to conduct the audit on the basis that there is an assumption that revenue recognition is a fraud risk. Work is therefore required to ensure that all income is recognised appropriately and in line with the charity's accounting policies and the charity SORP. We are also required to confirm that income has been correctly classified between restricted and unrestricted funds.	Obtain an understanding of all sources of income, and any contracts or terms & conditions attached. Sample testing income, verifying to supporting documentation to ensure income has been recognised in the correct period. Cut off testing around the period-end to ensure all income is included in the relevant period. Review to ensure that income has been correctly classified between restricted and unrestricted funds, reviewing any terms and conditions etc. Analytical review.	Nothing has come to our attention to suggest there is any fraud risk associated with revenue recognition, however we have made some general comments and recommendations relating to income from the café and car park meters in section 7 of this report.

5. Overall audit strategy

Significant risk	Explanation of the risk	Audit work performed	Conclusion
Management override (mandatory risk)	The corporate trustee and other management have the primary responsibility for the detection of fraud, as an extension of their role in preventing fraudulent activity. The Corporate trustee should ensure a sound system of internal controls is in operation to support these, and other, objectives. Auditing Standards presume a significant risk of management override of the system of internal controls, because management can often find themselves in a unique position where they could potentially override routine day to day financial controls. Our audit is designed to provide reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or error. We are not responsible for preventing fraud or corruption, although our audit may serve to act as a deterrent.	Management often find themselves in a unique position where potentially could override routine day to day financial controls. Our audit considers this risk and we adapt our procedures accordingly. During our audit we considered the possibility of manipulation of financial results, for example through the use of journals or management estimates, such as provisions and accruals.	Our audit procedures have not identified any instances of management override.

5. Overall audit strategy

Significant risk	Explanation of the risk	Audit work performed	Conclusion
Non-depreciation of freehold buildings	Where the accounting policy is not to depreciate it is necessary to complete an annual impairment review to consider the carrying value of the buildings. Due to the absence of depreciation there is a risk that the carrying value of the property is overstated. If this were to be the case funds will also be overstated.	Review and analysis of any impairment review undertaken.	No impairment review was carried out by the charity. However from our own impairment review carried out, the non-depreciation of freehold buildings appears appropriate.

6. Status of audit issues raised in prior year

This section updates you on the status of the issues your previous auditors brought to your attention last year, and confirms whether any further action is required.

	Issue / Observation arising in 2015	Risk rating in prior year	Solution suggested in prior year	Follow up comments, including whether further action required	New risk / priority rating
1.	**General charity records.** During the audit we had significant difficulty in trying to agree the amounts included in the accounts and as a result had to spend a considerable amount of time in reworking the 2015 accounts to a position where we were comfortable with the figures. There is a distinct lack of an audit trail and this is mainly down to the fact that the charity's records are so intrinsically linked to MBC records that the accounts are effectively created from the council ledger and spreadsheets. This therefore appeared to result in some amounts being included in the charity's accounts as a balancing figure in order to get MBC's books to agree.	 High	We would strongly recommend that MBC set up the charity's own accounting records. This could be done by way of a spreadsheet or alternatively it may be easier to use a simple piece of accounting software. This would enable MBC to record the double entry of all transactions which relate to the charity, even if the transaction goes through the MBC bank account. To do this a MBC loan/intercompany account would need to be set up in the charity's records and every time a CME transaction goes through the MBC bank account then an entry can be made to the loan account, with a corresponding debit to expenditure or credit to income. If something similar is set up in MBC then, as a double check, the two loan accounts should always agree.	The records have not yet been set up separately for the charity, although the records supporting the creditor loan balance for amounts owing to MBC were much clearer this year.	 Med

6. Status of audit issues raised in prior year

	Issue / Observation arising in 2015	Risk rating in prior year	Solution suggested in prior year	Follow up comments, including whether further action required	New risk / priority rating
2.	**Capital expenditure.** As part of our audit testing it was identified that capital costs of £963k for the visitor centre, Kent Life and playground had not been capitalised, instead incorrectly being treated as an income and expenditure item. A significant part of the £963k related to previous years, resulting in a prior period adjustment being required. Furthermore an additional capital accrual was identified as part of our after date invoice review.	Med	In future we recommend that you carefully review any potential capital costs to ensure that they are treated correctly in the accounts. Any capital items that are deemed to be a work in progress should be treated as 'assets under construction'. It is recommended that material after date invoices received are reviewed to ensure that all amounts relating to 31 March are included in the accounts.	Capital expenditure incurred during 2015/16 has generally been accounted for correctly, although some adjustments have been agreed with you, for example £30k of café equipment has been capitalised with your agreements, plus a further £5k for the mono-pump in relation to irrigation works. We recommend that in future you carefully check to ensure that all expenditure which should be capitalised has indeed been treated this way.	Low
3.	**Unincorporated legal status of the charity.** The charity is structured as an unincorporated trust, with no limited liability for the corporate trustee, Maidstone Borough Council. Our management letter last year set out various risks associated with this current set up, which we will not repeat again here.	Med	We recommend you give consideration to changing the legal structure of the charity, and consider both the limited by guarantee company and new CIO structure.	We understand that this issue has been considered and, for now, the corporate trustee is comfortable with the position, however our previous advice in respect of this observation remains.	Med

6. Status of audit issues raised in prior year

	Issue / Observation arising in 2015	Risk rating in prior year	Solution suggested in prior year	Follow up comments, including whether further action required	New risk / priority rating
4.	**VAT.** As noted in the independence section, we have been asked to carry out a VAT review, separate to the audit. This VAT review and the report issued to you identified that the all sources of income received during the year were exempt from VAT. Therefore even if the charity were voluntarily registered for VAT, input VAT would not be able to be reclaimed on purchases as they are deemed to be exempt supplies. We noted from our audit testing that Maidstone Borough Council have been claiming input VAT on the charity's behalf for a number of years, and we believe that this is incorrect. We have not been able to quantify the amount involved but it is likely to be substantial.	 Med	We would recommend that Maidstone Borough Council stop reclaiming input VAT on the charity's behalf with immediate effect. We would also advise that you seek professional advice to quantify the amount likely to be recovered by HMRC.	UHY completed our VAT review in late 2015 and early 2016. The charity has now been registered for VAT in its own name from 1 April 2016, the first day of the next accounting period. Given the income in the year 2015/16 from income streams which would count towards the VAT registration thresholds, there is potentially a risk that HMRC could challenge whether the charity should have registered before it did, and raise an assessment for the output tax that should have been declared.	**This matter has been dealt with and resolved**
5.	**Fund accounting.** The charity has received some donations that were received specifically for capital purposes, however this income has been incorrectly recognised through the general unrestricted funds.	 Med	It would be normal for any income (grants or donations) received specifically for capital purposes to be allocated to a restricted fixed asset fund. This helps to ensure that the capital income is spent in line with the purposes intended.	The only restricted income in 2015/16 is the income from the Will Trust, reflected as a donation, and this has correctly been treated within restricted funds.	**This matter has been dealt with and resolved**

6. Status of audit issues raised in prior year

	Issue / Observation arising in 2015	Risk rating in prior year	Solution suggested in prior year	Follow up comments, including whether further action required	New risk / priority rating
6.	**Fixed assets.** It was noted during our fixed assets testing that an impairment review had not been carried out. Where the accounting policy is not to depreciate it is necessary to complete an annual impairment review to consider the carrying value of the buildings.	Low	In order to ensure that the carrying value of the property is not overstated, it is important that the charity carries out an annual impairment review. This should be done in advance of the audit fieldwork.	A valuation has been procured during the year showing that the Manor Golf course and also the visitor centre/café were being carried in the accounts in excess of current value, and hence an adjustment was made by you to reduce the carrying value. The Golf Course has been revalued to an amount equal to 7/9th of the valuation report to reflect that the charity only owns 7/9th of the land, the remaining 2/9th being held by MBC. Discussions with finance staff have enabled us to conclude that there are no further indicators of impairment, and that therefore an impairment review is not required.	Low
7.	**MBC creditor** Due to the number of changes made to the original accounts presented for audit, it was difficult to agree the year end MBC council to third party supporting documentation. Ideally there should be an easy way of agreeing and identifying the balance in the MBC accounts especially as it is such a significant number.	Low	This is linked to the point raised re: the inadequacy of the charity's records so please see the significant deficiencies in internal control section.	We were provided with MBC's audited accounts for the year ended 31 March 2016, together with supporting schedules, to which we were able to agree the MBC creditor balance (there is a £347 difference due to a difference on the trial balance relating to additional expenses)	**This matter has been dealt with and resolved**

7. Recommendations for the current year

Significant deficiencies in internal control

We are required to report to you, in writing, significant deficiencies in internal control that we have identified during the audit. These matters are limited to those which we have concluded are of sufficient importance to merit being reported to you. As the purpose of the audit is for us to express an opinion on the charitable company's financial statements, you will appreciate that our audit cannot necessarily be expected to disclose all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist. As part of our work, we considered internal control relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. This work was not for the purpose of expressing an opinion on the effectiveness of internal control.

We confirm that we have not identified any significant deficiencies in internal control during the 2016 audit.

We are also required to communicate other significant audit findings such:

- where we consider a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate in the particular circumstances of the entity;
- significant difficulties, if any, encountered during the audit; or
- other matters, if any, arising from the audit that, in our professional judgement, are significant to the oversight of the financial reporting process are communicated to those charged with governance.

We have had some difficulties, with these mainly arising due to the immediate availability of accounting records for the new income streams, especially the café. Specific comments are made later in section 7 about the café.

With the exception of the above issue we have nothing to bring to your attention in respect of the three bullet points above.

7. Recommendations for the current year

Other deficiencies in internal control

We also bring to your attention other deficiencies that came to our attention during our work, again along with our recommendations, and your own response:

Medium risk/priority

Low risk/priority

	Priority	Area	Observation	Recommendations	Management response
1.		Café records	A number of observations were made in respect of the records over café income and expenditure: • The café records were not immediately available; • There was no clear record linking the daily takings to bankings; • For a period of time taking were allowed to accumulate into larger sums before being banked. Holding large sums of cash like this is not ideal to the risk of theft etc.	It is important that all accounting records, for all income streams, are passed through to the people responsible for maintaining the financial records. We understand that since April 2016, the amount recorded from the till daily has been the amount banked on each paying in slip, to ensure a clear audit trail.	

7. Recommendations for the current year

	Priority	Area	Observation	Recommendations	Management response
2.	 Med	Potential tax on commercial trading activities	The charity has generated significant income in 2015/16 from two income streams (the café and car parking) which could be seen to be commercial trading. For the purpose of the accounts we have included this income under the heading of 'charitable income' on the basis that the expansion of the facilities falls very loosely into the charitable object of benefitting the inhabitants of Maidstone. Charities with income of over £200k have a small scale trading limit of £50k, and are permitted to carry out trading and generate income (not profits) up to this level without incurring a tax liability. In 2015/16 it appears from the information available to us that the café function has operated at a loss for the period from opening in August 2015 to 31 March 2016. With few costs associated with the car park the profit from the car park is likely to be close to the income figure of £26k. We are aware from discussions with you that income from both the café and the car park are expected to be substantially higher for the first full year of operation through to 31 March 2017. There is a risk that, if the café has been profitable, and potentially just due to the car parking income, that the charity will have a tax liability for 2016/17 (although any losses for 2015./16 should be available to offset against some of these profits). Any tax issues would disappear if it is possible to argue that income and profits from these two sources fall into, or are closely related, to the charity's objects.	We pointed out this potential tax issue last year (in an email from Brian Carey on 12 February 2016), questioning whether the charitable trust had ever been required to submit a tax return to HMRC. In this email we acknowledged that HMRC may be content that no tax charge arises because the income from the golf course, which at the time was the main income potentially subject to tax, was being applied for charitable purposes. We did, however, suggest that with the changes in the type and scale of income received by the trust going forward that this point should be raised with HMRC to ascertain the filing requirement that the Trust will have. We have not been asked to look into this further, and are not aware that you have had any discussions with HMRC. We recommend that the tax position of the charity is given some immediate thought.	

7. Recommendations for the current year

	Priority	Area	Observation	Recommendations	Management response
3.	Med	Financial performance of the café	The café has made a significant loss (c. £90k) during the period, which we know you are aware of. Nevertheless we feel the need to draw attention to the need to put measures in place as soon as possible to improve the financial performance of the café.	The loss largely arises due to high staff costs, and the use of expensive agency staff in particular. From our review of your forecast and year to date performance for 2016/17 a further loss of approaching £100k is forecast, and so we recommend that you careful review how the café can be returned to profitability or even a break even position. We would remind you that the corporate trustee has a responsibility to ensure charitable funds are not put at risk, and by 31.3.17 the café will have suffered a deficit of nearly £200k across the first year and a half of operation.	
4.	Low	Car park income	The records relating to income from car parks could be improved. There was no clear record on the accounting system to breakdown income by car park, nor is there a clear record of season ticket parking sales.	It would be helpful if income from each car park is recorded separately, which would enable comparisons between periods to be made easily. Season ticket sales should be recorded separately since if these straddle accounting periods it may be necessary, if sufficiently material, to consider deferring some income into the next period.	
5.	Low	Amortisation of website costs	No amortisation (depreciation) had been included in respect of the new website costs, and so an adjustment has been agreed with you for £12,500.	The charge included will write off the cost of the £50k investment over a 4 year period. In future years you should ensure this amortisation charge is reflected in the accounts before the audit.	

Appendix I - Agreed accounting adjustments

A significant number of differences have been identified during the audit and posted to the statutory accounts, following agreement with your key management:

Net expenditure/deficit before investment gains/losses per client		(78,200)
Being reanalysis of Cafe set up costs	33,396	
Related depreciation costs	(3,340)	
	-----------	30,056
Reanalysis of service charges & other receipts	32,698	
S/c and other receipts re electricity	(16,892)	
S/c and other receipts re Sewage	(8,553)	
S/c and other receipts re Water	(7,253)	
	-----------	-
Being the depreciation charge on plant and machinery not posted		(2,513)
Amortisation of intangible assets (website)		(12,500)
Capitalisation of new mono pump re irrigation works		5,156
Debtor for oven reimbursement due from MyTime		9,266
Difference on trial balance relating to additional expenses posted that would increase MBC creditor		(347)

Total impact of all agree accounting adjustments		29,118
Net expenditure/deficit before investment gains/losses per financial statements		**(49,082)**

Appendix II – Unadjusted audit differences

We are required to bring to your attention audit adjustments that the corporate trustee is required to consider. We confirm that no such adjustments were identified.

		£
Net expenditure/deficit per accounts before investments gains/losses		(49,082)
Dilapidation costs capitalised which appear to be professional expenses in nature and perhaps should therefore be expense through the SoFA		(5,568)
Being the capitalisation and depreciation charge of the coffee machine identified during the repairs and renewals testing	4,220	
	(422)	
	-----------	3,798
VAT recoverable on coffee machine above		844

Total impact of unadjusted differences		(926)
Net expenditure/deficit before investment gains or losses if unadjusted differences all included		**(50,008)**