AUDIT COMMITTEE	AGENDA ITEM No. 9
23 SEPTEMBER 2013	PUBLIC REPORT

Cabinet Member(s) responsible:	Resources portfolio holder, Cllr Seaton	
Contact Officer(s):	John Harrison, Executive Director Strategic Resources Steven Pilsworth, Head of Strategic Finance	☎ 452398 ☎ 384564

2012/13 REPORT TO THOSE CHARGED WITH GOVERNANCE AND STATEMENT OF ACCOUNTS

R E C O M M E N D A T I O N S	
FROM : John Harrison, Executive Director Strategic Resources	**Deadline date :** 23 September 2013
The Audit Committee is asked to:- 1. Receive and approve the "Report to those charged with governance (ISA260) 2012/13 Audit" from PricewaterhouseCoopers (PwC), the Council's external auditors. 2. Receive and approve the audited Statement of Accounts 2012/13	

1. ORIGIN OF REPORT

1.1. This report is submitted to Audit Committee following the external audit on the Statement of Accounts 2012/13 by PricewaterhouseCoopers (PwC). This report is required to be considered by the Audit Committee on behalf of the Council by 23 September 2013.

1.2. This is in accordance with the Committees Terms of Reference – 2.2.19 to review the annual statement of accounts and 2.2.20 to consider the external audit report to those charged with governance on issues arising from the audit of accounts.

1.3. This report follows on from the consideration of the Council's unaudited Statement of Accounts by this Committee on 24 June 2013

1.4. This report is submitted by the Council's Section 151 Officer, the Executive Director Strategic Resources, as part of his statutory duties.

2. PURPOSE AND REASON FOR REPORT

2.1 The purpose of this report is for the Audit Committee to:

- Receive and note the "Report to those charged with governance (ISA260) 2012/13 Audit" from PwC on behalf of the Council.
- To receive and approve the audited Statement of Accounts.

3. TIMESCALE

Is this a Major Policy Item / Statutory Plan?	**NO**	If Yes, date for relevant Cabinet Meeting	N/A

4. 2012/13 REPORT TO THOSE CHARGED WITH GOVERNANCE

4.1. The External auditors have a statutory requirement to report to members under the Audit Commission's Code of Audit Practice and International Standard of Auditing (UK and Ireland) (ISA(UK&I) 260 – "Communication of audit matters with those charged with governance". The report is known as the ISA260.

4.2. The ISA260 report for 2012/13 from PricewaterhouseCoopers (PwC), our External Auditors is attached at Appendix 1.

4.3. With the implementation of International Reporting Standards (IFRS) during 2010/11 the audit approach taken by the auditors has been amended and requires the auditors to undertake additional audit procedures on areas of the accounts where the Council uses experts in order to derive estimated values. For the Council the significant areas of the accounts this affects are asset valuations, such as property, land and investments, and with pension fund accounting treatment.

4.4. There are a number of sections within the ISA260 report as follows:

a) **Executive summary** – describes the purpose of the report, and gives a summary of the Audit. The Council has continued to provide good quality working papers ready for the audit commencement and working alongside PwC colleagues has resulted in an efficient and effective audit which in turn has led to earlier audit milestones being achieved.

b) **Audit Approach** – notes two significant risks that are common in all audits undertaken and notes that PwC found no matters to report to the Audit Committee.

c) **Significant audit and accounting matters** – this section forms the main content of the report, and consists of a number of subsections, a number of these are summarised below:

- Accounts – PwC have been able to complete the majority of the audit with three items that remain outstanding at the time the report is written. The items listed represent one area of work the audit team are required to complete relating to the Pension Fund and two approvals which are required at this meeting. These items are outstanding due to the timing of writing the report rather than from delays caused through a lack of information from Council officers.
- Accounting Issues – four areas are highlighted (considered in greater detail in 4.5) :
    - Accounting for the construction of new academy schools
    - Valuation of property
    - Accounting for the Local Authority Mortgage Scheme (LAMS)
    - Estimation of the pension liability, for the Local Government Pension Scheme
- Misstatements and significant audit adjustments – LAMS is the only item reported in this section and is a result from difference in opinion on the technical accounting treatment, see 4.5 for additional information.
- Economy, efficiency and effectiveness – the report notes that an unqualified value for money conclusion is anticipated to be issued.

d) **Internal Controls** – there were no significant internal control deficiencies found during the audit. Minor control issues will be reported to management and this report along with agreed action plans will be presented to the Audit Committee.

e) **Risk of Fraud** – PwC are seeking members' confirmation that there have been no changes to their view of fraud risk and no additional matters have arisen that should be brought to their attention.

f) **Fees update** – fees are currently in line with proposals.

g) **Appendix** – a copy of the letter of representation for the Councils S151 officer to sign (Appendix 2 to this report).

4.5. The following table provides further detail on the Accounting Issues raised in the PwC report, and associated comments from the Council:

PwC Report	Management Comment
1. Accounting for the construction of new Academy schools During the year, the Authority has been constructing two new academy schools; the City of Peterborough Academy and the Thomas Deacon Junior School which are part funded by Department of Education grants. These two academies will transfer to Greenwood Dale Academies Trust upon completion in June 2014. The Authority initially capitalised this expenditure and then impaired this to nil, as the assets will be owned by the Authority only until the transfer date, will not receive the economic benefit from the assets. PwC have reviewed the substance of each transaction and determined that in accordance with the CIPFA Code the capital expenditure incurred in relation to the academies should instead be treated as Revenue Expenditure Funded from Capital Under Statute (REFCUS). REFCUS would be recognised within the Comprehensive Income and Expenditure Statement in the period in which it is incurred. A transfer is then made from the Capital Adjustment Account so there is no impact on the balance of the General Fund.	Academies are the responsibility of Government and as such do not form part of the Council's asset base and are not included on the Balance Sheet. The issue being reported by PwC relates to the accounting treatment of the capital expenditure incurred by the Council during 2012/13 for the development of these schools. The Council proactively opened dialogue with PwC on this technical accounting issue mid May in advance of closing the Council's accounts by the end of June. At this time PwC indicated that this issue needed to be referred to their internal technical department. Due to the timescales involved in closing the Council's accounts and receiving no further guidance on treatment, the Council stated to PwC the accounting treatment and logic it would be using for these transactions. In August 2013, as part of the audit of the accounts, PwC were able to confirm the correct accounting treatment. The Council agreed and subsequently amended the accounts accordingly. This amendment resulted in a presentational change in the Comprehensive Income and Expenditure Statement (CIES) as £7.7m of grant income was transferred from the 'Taxation & Non-Specific Grant Income' line to 'Education & Children's Services' line. Supporting notes to the main financial statements have also been amended.
2. Valuation of property The Authority has utilised the expertise of external valuer in evaluating the valuation of the Authority's property, plant and equipment (PPE) and investment properties. Our internal valuation experts have reviewed the assumptions and methodologies used by the Authority's external valuer. We draw your attention to the following in relation to these assumptions: 1. Depreciation and Useful Economic Lives (UEL) – the assumptions on the remaining lives were considered to be simplistic and should reflect the specific characteristics of the property. 2. Modern Equivalent Asset Basis - valuations calculated by the external valuer assume the replacement of existing property. The Royal	The Code requires the Council's S151 Officer to ensure that adequate valuations are provided to support the Council's financial statements in relation to PPE and investment properties. To comply with this the Council, through the use of its partners Serco, commission external valuers to value the Council's properties on a rolling four year programme. The Council uses the valuers Wilks Head and Eve (WHE), who are a national and professionally qualified Royal Institution of Chartered Surveyors (RICS) firm. PwC obtain valuation advice from their internal valuers on the suitability of the valuation approaches used by WHE. The Council has assessed the points made by PwC and have concluded that the valuations

<table>
<tr><th>PwC Report</th><th>Management Comment</th></tr>
<tr><td>Chartered Institute of Surveyors (RICS) guidance stipulates that the valuation should be undertaken on a Modern Equivalent Asset basis (MEA). Modern Equivalent means “replacement of an existing asset with a more technically up to date asset today, and provide the same level of service as any existing asset”.

3. Apportioning land values – The external valuer has used an approach of apportioning land values as a percentage of building costs in their valuation. However, PwC valuers would adopt an approach that derived the land values by using a land value per acre based on market comparables.</td><td>in the Council’s accounts are prudent. However, the Council will ensure that the points covered by PwC will be discussed further with the valuers to ensure mitigating actions are in place for the 2013/14 accounts.</td></tr>
<tr><td>3. Accounting for the Local Authority Mortgage Scheme

The Council has treated its payment of £1m to Lloyds as capital expenditure. The justification for this treatment is regulation 25(1)(b) of the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003, which defines as capital expenditure "... the giving of a loan, grant or other financial assistance to any person, whether for use by that person or by a third party, towards expenditure which would, if incurred by the authority, be capital expenditure".

We consider that an alternative interpretation of statue may be appropriate as, although the lender would not have made its loan to the borrower without the Council having placed money on deposit with it, the Council may not have a relationship with the borrower making the house purchase sufficient for regulation 25(1)(c) to be effective.</td><td>This issue is the same issue raised following the 2011/12 audit. The ISA260 report from that year recommended that the Council keep its accounting arrangements under review as statute and/or the CIPFA Code may change and require adoption of a different accounting treatment.

No such changes have occurred and therefore the Council has maintained the same the accounting treatment as used in 2011/12.

In summary, the substance of the transaction is to facilitate a greater amount of loan to a mortgagor than would otherwise be available. It would not be within an authority’s powers to designate the payment as an investment.

The Councils interpretation is that the payment is a loan / financial assistance towards expenditure which would, if incurred by the authority, be capital expenditure. If a local authority were granting a loan for house purchase, it would be treated as capital expenditure.

As per the previous year, if the statute or Code of Practice changed, then the Council would revisit its approach. Therefore the Council has not amended the accounts as suggested in the PwC report in Appendix 1 as it does not believe this amendment would reflect the substance of the transaction. As the amount involved is not material in the context of the truth and fairness of the accounts as a whole, there is no impact of this on the audit opinion.</td></tr>
<tr><td>4. Estimation of the pension liability

We have also received a report from the auditors of the Cambridgeshire County Council Pension Fund in August 2013, summarising their work on the pension fund as a whole. This report highlighted that the</td><td>The Council uses figures, provided by the Cambridgeshire County Council (CCC) Pension Fund appointed actuary, to derive the accounting entries use in the Council’s statement of accounts.

Due to the timing involved with producing the</td></tr>
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PwC Report	Management Comment
fair value of the whole pension fund as at 31 March 2013, as provided by the scheme actuaries Hymans Robertson LLP ("Hymans"), was £1,967m. However, the audited assets of the pension fund at this date were £1,904m, resulting in a difference of £63m between estimated and actual total fund assets as at the balance sheet date. In accordance with the CIPFA Code section 6.4.1.11, formal valuations are performed every three years with approximate assessments adjusting the full valuation results using the latest membership data in intervening years. Both the IAS19 asset derived from the actuary's report and the notional share of fund assets are deemed to be estimates. The notional share of the fund assets is calculated as part of the full valuation, and then used as part of the actuary's model for calculating the assets attributable to an admitted body until the next full valuation, the actual percentage in the intervening periods may differ from this and the percentage is therefore an estimate. Whilst we may know the audited value of the pension fund assets in the intervening years, applying the notional share of the assets to calculate the value attributable to an individual admitted body is itself an estimate (as the percentage may have changed), and the percentage applied is the more sensitive variable.	statement of accounts, the actuary uses a number of estimates in its production of the report that is used by the Council. This is a standard and common approach across all Councils. Following on from the audit of the CCC pension fund, completed by a different PwC team during August, the issue detailed has arisen. The Council's pension note, as contained in the Statement of Accounts (Note 7), provides full transparency of the estimation techniques the CCC Pension fund actuary uses. That triennial valuation of the fund is completed regularly, and any differences resulting from the use of estimates are adjusted for as part of the regular full valuation exercise.

5. MANAGEMENT REPRESENTATION LETTER

5.1. The Executive Director Strategic Resources, as Chief Finance Officer, is required to make representations on behalf of the Council in a number of areas in relation to the preparation of the Statement of Accounts. The letter is attached at Appendix 2 for review by Audit Committee.

6. STATEMENT OF ACCOUNTS 2012/13

6.1. The production of a timely Statement of Accounts, which is free from material error, is a key test of the robustness of financial processes and underpins the financial standing of an organisation. The Council has achieved this through the presentation of the Statement of Accounts in both June and September to Audit Committee, and also through the completion of a successful external audit process.

6.2. As noted in the PwC report, the Council has established a good track record of preparing quality draft accounts and electronic working papers and this good practice has again continued for the 2012/13 accounts. Further improvements have been made by the Council by implementing an electronic, integrated Asset Register which in turn enhanced the Council's capital working papers, and enabled a quicker closure process by the Corporate Accounting Teams. This subsequently enabled the audit process to be completed more efficiently with the number of additional auditor queries kept to a minimum, and an earlier

Audit Clearance meeting to take place 14 August 2013 compared to 5 September 2012 last year.

6.3. The draft Statement of Accounts was considered by Audit Committee on 24 June 2013 and has subsequently been the subject of external audit by PwC.

6.4. Following the external audit two minor presentational amendments have been made to the draft Statement of Accounts (presented to Committee in June) with regards to the accounting treatment for the construction of new Academy schools, see 4.5 for details, and with the pension fund balance so that it matches the Actuary report balances. This outcome is a credit to all the staff involved in the production of the Statement of Accounts, and thanks are extended to all staff who contributed to the closure process, either directly or indirectly.

6.5. The audited Statement of Accounts for 2012/13 is attached at Appendix 3 for formal approval by the Audit Committee.

7. CONSULTATION

A clearance meeting was held 14 August 2013 where PwC outlined their key findings and the Executive Director Strategic Resources, as part of his role as the Council's S151 Officer, was able to challenge those findings. The PwC report was discussed with the Council's finance team during the period 11 to 13 September 2013.

8. ANTICIPATED OUTCOMES

As set out in the report.

9. REASONS FOR RECOMMENDATIONS

Paragraph 2.2.19 of the Constitution requires the Audit Committee to "review the annual statement of accounts, specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the council."

10. ALTERNATIVE OPTIONS CONSIDERED

The Statement of Accounts has been prepared in accordance with the Code and hence there are no alternative formats.

11. IMPLICATIONS

There are no legal or financial implications of this report.

12. BACKGROUND DOCUMENTS

(Used to prepare this report, in accordance with the Local Government (Access to Information) Act 1985)

- Council Constitution

13. APPENDICES

- Appendix 1 - ISA260;
- Appendix 2 - Management representation letter being; and
- Appendix 3 - Statement of Accounts.