AUDIT COMMITTEE	AGENDA ITEM No. 6
22 SEPTEMBER 2014	PUBLIC REPORT

Cabinet Member(s) responsible:	Resources portfolio holder, Cllr Seaton	
Contact Officer(s):	John Harrison, Executive Director Resources Steven Pilsworth, Head of Strategic Finance	☎ 452520 ☎ 384564

2013/14 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 Resources	**Deadline date :** 22 September 2014

The Audit Committee is asked to:-

1. Receive and approve the "Report to those charged with governance (ISA260) 2013/14 Audit" from PricewaterhouseCoopers (PwC), the Council's external auditors.
2. Receive and approve the audited Statement of Accounts 2013/14.

1. ORIGIN OF REPORT

1.1. This report is submitted to Audit Committee following the external audit on the Statement of Accounts 2013/14 by PricewaterhouseCoopers (PwC). This report is required to be considered by the Audit Committee on behalf of the Council on 22 September 2014.

1.2. This is in accordance with the Committees Terms of Reference – 2.2.18 to review the annual statement of accounts and 2.2.19 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 30 June 2014.

1.4. This report is submitted by the Council's Section 151 Officer, the Executive Director 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) 2013/14 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. 2013/14 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 2013/14 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.

b) **Audit approach** – notes three significant risks that are common in all audits undertaken, fraud and management override of controls, recognition of income and expenditure and financial resilience. PwC found no matters to report to the Audit Committee for the first two risks and for the third, financial resilience, informs the Audit Committee that it has found no matters that would cause them to modify their Use of Resources conclusion.

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 five items outstanding at the time the report is written. Three of those items relate to areas of work the audit team are required to complete, these are review of the adjustments to the Statement of Accounts, review of the Whole Government Accounts Schedules and completion of the Use of Resources conclusion. One item relates to two approvals required at this meeting and the last item is completed after Audit Committee. 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 – These were outlined in the Audit Plan and were areas which PwC deemed to be at elevated risk. These risks were determined by risk assessments on national issues as well as items based on PwC's understanding of the Council. Four areas are highlighted (considered in greater detail in 4.5) :
  - Accounting for property plant and equipment
  - Estimation of the pension liability for the Local Government Pension Scheme
  - Council tax benefit reform
  - Accounting for the Local Authority Mortgage Scheme (LAMS)
- Misstatements and significant audit adjustments – There were no misstatements to report other that the trivial item below and no significant adjustments apart from the prior period adjustment detailed in section 4.5.

  Trivial misstatements - as part of the revenue testing PwC identified an invoice raised in error of £4k within Communities Department and ISA guidance requires the extrapolation of this error across the total income of the Council. Given that income is raised across the Council by each Department and the underlying information used to generate the invoices raised is different in each Department, management do not consider this a reasonable assumption. Within the testing undertaken by PwC no further errors were detected, but ISA guidance has required the statistical extrapolation method to be used to quantify a potential level of error of £380k.

- Related parties – details of what is evaluated and the new requirement this year that the S151 Officer represents the list of related parties disclosed in the financial statements is complete and accurate.
- Economy, efficiency and effectiveness – the report notes that an unqualified value for money conclusion is anticipated to be issued.

d) **Internal Controls** – there were four significant internal control deficiencies found during the audit, three of which relate to the accounting for property, plant and equipment and the fourth relates to access to data files and super user access to applications. Further details of these are given in section 4.6. 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 will vary from those proposed in the Audit Plan due to additional testing required during the audit and work undertaken in consideration of questions raised by local electors.

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 property plant and equipment. a. Assets under construction (AUC) It has been identified that extensions to two schools included within the AUC balance as at 31 March 2013, were actually completed during 2012/13 and should have been transferred into land & buildings. Both schools, including their extensions, were revalued at 31 March 2013 by the Authority's external valuer. As such the extension was incorrectly included within AUC as well as land & buildings. b. Valuation of Property The Authority has utilised the expertise of an external valuation expert to value the Authority's Property, Plant and Equipment and investment properties. Our valuation experts have reviewed the assumptions and methodologies used by the Authority's external valuation expert. We draw your attention to one matter in relation to these assumptions - 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. This matter regarding the assumptions has	a. Assets under construction This error occurred in 2012/13 and during 2013/14 the error relating to one of the schools, £9.3m of the total £11.1m error, was detected by the Corporate Finance team and corrected in the 2013/14 accounts. As part of the audit PwC tested the correction and determined that the correction for the two schools should be made as a prior period adjustment rather than corrected in year. With the increasing size of the Schools' capital programme it had become apparent during 2013/14 that extra resource was needed to support links to support the corporate functions of Adults, Childrens, and Communities directorates and oversee the schools capital programme. An additional post was created and a new experienced capital accountant was recruited to this position in August 2014. With the establishment of this new role procedures will be implemented to ensure that any valuation instructions are only issued by the service capital accountants or the Corporate Capital team. b. Valuation of Property 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

PwC Report	Management Comment
been reviewed and considered by Management who are comfortable that the assumptions and methodology adopted by the external valuer do not materially misstate the financial statements. c. Review of assets in use At each year end the Authority requires each service to confirm that all assets held by that service are still in use. As part of our audit procedures, we seek to place reliance on this control and we physically verify a sample of assets to confirm their existence. This year further emphasis was placed on the process by the Corporate finance team. This resulted in a “cleansing” of the fixed asset register of assets which were no longer in use by the services. In turn this led to entries in the PP&E note within the financial statements to remove such assets which largely had net nil book values We have undertaken procedures to assess the appropriateness of these entries and to also physically verify assets notified as still in use by the services. This testing identified some assets within Children’s Services which had been stated as disposed of within the return made by the service to the Corporate team, however the assets were still in use. These items are clearly trivial for adjustment. In addition, we identified some items which had been capitalised by the Authority but were no longer the Authority’s property. For example, bicycles which had been donated to families as part of a support scheme and were no longer owned by the Authority. Such items should have been treated as revenue expenditure funded from capital under statute (REFCUS). These items are clearly trivial for adjustment.	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. Management is pleased to note that PwC are not minded to challenge the valuations recorded in the accounts, however while they recognise these are professional differences of opinion as to valuation methodologies they will be formally raising the matter with WHE. c. Review of Assets in use. In 2012/13 a new Fixed Asset Database, Technology Forge (TF), was implemented which holds details of the Council’s Asset Portfolio, previously the data was held on large and complex spreadsheets. Following the successful implementation in 2012/13, during 2013/14 an exercise was carried out by the Corporate Team to ensure that all assets contained in the database were correct and could be verified. This additional control implemented by the Corporate Capital team led to a complete review of assets by each service and the elimination of assets no longer owned by the Council but still held on the balance sheet. These assets had largely been fully depreciated but not written out of the asset register. As in point a above, with the increasing size of the Schools’ capital programme it had become apparent during 2013/14 that extra resource was needed to support links to support the corporate functions of Adults, Childrens, and Communities directorates and oversee the schools capital programme. An additional post was created and a new experienced capital accountant was recruited to this position in August 2014. With the establishment of this new role procedures will be implemented to ensure data submitted by services to the Corporate Team is sufficiently detailed and robust.
2. Estimation of the pension liability We undertook audit work on the data supplied to the actuary on which to base their calculations. We noted that within the submission made by Local Government Shared Services (LGSS) on behalf of the	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

PwC Report	Management Comment
Authority, one month of payroll data was omitted. The data was therefore resubmitted to the actuary and a recalculation performed on the complete pension contributions made for the year. This resulted in an increase to the closing liability of £0.7m and an increase to the closing fair value of scheme assets of £0.6m. The Authority has corrected the financial statements for the balances within the updated actuarial report	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. As part of the audit process PwC obtain evidence from the actuary to review the basis of the actuary calculations and it was during this review that the error was identified. Management will be raising the matter with LGSS who administer the CCC Pension Fund.
3. Council Tax benefit reform As a new scheme has been introduced we have performed additional audit procedures this year to: • Understand the criteria the Authority has set and the initial modelling performed to estimate the cost of the scheme; • Review the accuracy of budget monitoring and reporting of CTS; • Understand and evaluate the change processes and access to the Academy system; and • Review the parameters now used within the Academy system. We have also undertaken focused testing on a sample of transactions under the new arrangements Due to the localisation of schemes the Audit Commission has revised their certification instructions (as DWP involvement ceases with the new CTS schemes) and we have therefore needed to perform additional detailed testing procedures as part of the financial statements' audit to gain assurance over the accuracy, completeness, cut-off and existence of a sample of Council Tax Support claims.	Management are pleased to note that PwC have no issues to report regarding the additional work performed on the Academy system or on the Council Tax Support claims balance included within the financial statements.
4. 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".*	This issue is the same issue raised following the 2012/13 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 2012/13. 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

PwC Report	Management Comment
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.	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. The Council has taken advice from its own legal advisors and received Legal Counsel's advice via Capita its Treasury Advisor as to the legal validity of this accounting treatment. As per the previous year, if the statute or Code of Practice changed, then the Council would revisit its approach.

4.6. The following table provides further detail on the Internal Control Deficiencies raised in the PwC report, and associated comments from the Council:

PwC Report	Management Comment
1. Assets under construction The Authority needs to ensure more rigorous monitoring of progress of AUC. We recommend closer liaison between the Corporate team who manage the fixed asset register and the service teams who should be aware of the progress of AUC within their area. A review of all AUC should be performed at year end to confirm whether they have been completed.	The problems arose in 2012/13 and 2013/14 within Children's services. The control weaknesses were identified by management and an additional post was created to support links to support the corporate functions of Adults, Childrens, and Communities directorates and oversee the schools capital programme. A new experienced capital accountant was recruited to this position in August 2014
2. Instructions to external valuers We recommend that the Authority's procedures regarding instructing the external valuers are reviewed and re-issued to the relevant members of staff. This will ensure that appropriate instructions are given to the external valuer by only the Corporate team. The list of valuations returned should be checked back to the instructions to ensure a complete list of valuations has been received.	With the establishment of the new role overseeing the Schools capital programme new procedures will be implemented to ensure that any valuation instructions are only issued to the Council's valuers by the service capital accountants or the Corporate Capital team. A new year end procedure will be established with the Corporate Capital team to verify that each valuation received and entered to the Asset Register is one that has been correctly requested.
3. Appropriate treatment of assets as REFCUS(revenue expenditure funded from capital under statute) The Authority should consider the nature of assets capitalised and ensure treatment as REFCUS as appropriate.	The implementation in 2012/13 of an Asset Register database, Technology Forge (TF) enables additional data to be held for each asset. Additional data will be requested from the service teams to ensure that the Corporate Capital team have sufficient data to evaluate each asset for capitalisation or treated as REFCUS.
4. Access to datafiles and super user access to applications	The Financial System Services team currently have the ability to carry out system wide set up changes to the look, feel and configuration of

PwC Report	Management Comment
Access to data files should be restricted to non operational personnel ie segregation of duties should be maintained between data base access and application access.	the finance system including the tasks listed below: - User access User access levels and limitations Approval hierarchies Transactional processing formats and fields System security and controls System tolerances Configuration changes This access is restricted to a system administration and super-user level of access so that control can be provided over these changes. Any changes are only made when the required audit trail and necessary approval is received.

5. MANAGEMENT REPRESENTATION LETTER

a. The Executive Director 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 2013/14

b. 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.

c. The draft Statement of Accounts was considered by Audit Committee on 30 June 2014 and has subsequently been the subject of external audit by PwC.

d. Following the external audit two amendments have been made to the draft Statement of Accounts (presented to Committee in June) with regards to estimation of the pension liability and the assets under construction prior period adjustment, see 4.5 for details.

e. The audited Statement of Accounts for 2013/14 is attached at Appendix 3 for formal approval by the Audit Committee.

7. CONSULTATION

A clearance meeting was held 21 August 2014 where PwC outlined their key findings to the Head of Strategic Finance, as part of his role as the Council's deputy S151 Officer. The PwC report was discussed with the Council's finance team during the period 3 to 11 September 2014.

8. ANTICIPATED OUTCOMES

As set out in the report.

9. REASONS FOR RECOMMENDATIONS

Paragraph 2.2.18 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; and
- Appendix 3 - Statement of Accounts.