

AUDIT COMMITTEE	AGENDA ITEM No. 4
22 SEPTEMBER 2016	PUBLIC REPORT

Cabinet Member(s) responsible:	Resources portfolio holder, Cllr Seaton		
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2015/16 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, Corporate Director Resources	Deadline date : 22 September 2016
The Audit Committee is asked to:-	
1. Receive and approve the "Audit Results Report - (ISA260) for the year ended 31 March 2016" from Ernst & Young (EY), the Council's external auditors.	
2. Receive and approve the audited Statement of Accounts 2015/16.	

1. ORIGIN OF REPORT

1.1 This report is submitted to Audit Committee following a referral from the s151 Finance Officer.

2. PURPOSE AND REASON FOR REPORT

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

- Receive and note "Audit Results Report - (ISA260) for the year ended 31 March 2016" from Ernst & Young (EY) on behalf of the Council.
- To receive and approve the audited Statement of Accounts.

2.2 This report is for Audit Committee to consider under its Terms of Reference No. 2.2.16 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 and 2.2.17 to consider the external audit report to those charged with governance on issues arising from the audit of accounts.

3. TIMESCALE

Is this a Major Policy Item/Statutory Plan?	NO	If Yes, date for relevant Cabinet Meeting	N/A
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4. MAIN BODY OF REPORT: 2015/16 REPORT TO THOSE CHARGED WITH GOVERNANCE AND STATEMENT OF ACCOUNTS

2015/16 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 2015/16 from Ernst & Young (EY), the Council's external auditors is attached as Appendix 1.

4.4 This is the first ISA260 report that Audit Committee has received from our new auditors. Whilst the format of the report is different to the one that the Council's previous auditors, PriceWaterhouseCoopers, (PwC) produced it is designed to meet the same statutory requirements. There are a number of sections within the ISA260 report as follows:

- a) **Executive summary** – describes the purpose of the report and a summary of the Audit.
- b) **Responsibilities and purpose of our work** – outlines the Council's responsibilities and the purpose of the work EY have undertaken, which is covered by the report.
- c) **Financial Statements audit** – this section forms the main content of the report, and consists of a number of subsections, some of these are summarised below:
 - Addressing audit risks – Notes the risks identified in the Audit Plan, the audit procedures performed in relation to them and the assurance gained, and issues arising as a result of the audit work performed. There are a mix of types of risks identified, from the general risk such as management override of controls and fraud which any organisation would face and are not specific to the Council, and as such are audited for all councils, and those more specific to the Council, such as the property valuation assumptions and methodologies used by the Council's external valuers, the accounting treatment for the Council's Private Finance Initiative, minimum revenue provision following the revised 2015/16 policy as agreed as part of the MTFs in March 2016, and the Council's assessment of the boundary with regards to Group Accounts. Other financial statement risks identified include recognition of the new financial system used by the Council and Better Care Fund accounting. Further comment is provided on some of the audit findings in 4.5 of this report.
 - Control themes and observations – EY report that they only test internal controls to the extent necessary for them to complete their audit and that they have not identified any significant deficiencies in them. EY also report that the Annual Governance Statement is not misleading or inconsistent with other information they have reviewed.
 - Whole of Government Accounts – due to delays in the issuing of national guidance to auditors, work on this is still be completed. Any matters that arise will be reported to Audit Committee.
- d) **Value for money** – this had been identified as a significant risk within the audit plan due to the impact of national funding reductions for local government. EY note that the 2016/17 budget is balanced through the use of efficiencies and income plans and that further significant savings are required in the coming year. Comparing the size of the savings to the Council's gross expenditure, and taking into account the Council's track record of delivering savings, they consider the plans reasonable and expect to issue an unqualified value for money conclusion.
- e) **Appendix A - Corrected audit differences** – reports some material presentational adjustments which have been amended in the accounts. These relate to income and expenditure that was misclassified due to coding issues and had no impact on the bottom line totals of the affected tables or the Council's financial position. The Corporate Accounting Team are providing refresher training on the importance of correct coding on the financial system to ensure these misclassifications do not occur in the future.
- f) **Appendix B – Independence** – confirmation that there are no changes in EYs assessment of their independence.
- g) **Appendix C – Auditor fees** - as anticipated in the Audit Plan, an additional fee will be charged as a result of work that has been undertaken to address specific risks included in the plan. The amount of this additional fee is still to be confirmed.
- h) **Appendix D – Draft Audit Report** – this is a draft copy of the Independent Auditors' Report to the Members of Peterborough City Council which is included in the Statement of Accounts and will be signed following the completion of the audit.
- i) **Appendix E – Management representation letter** - a draft copy of the letter of representation for the Council's S151 officer and Chair of Audit Committee to sign (Appendix 2 to this report).

j) **Appendix F – Required communications with the Audit Committee** – Outlines the communications that the auditors must provide to Audit Committee and method of communication.

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

EY Report – summary of points raised	Management Comment
<p>1. Previous audit issue - Lack of reconciliation of Gross Internal Area (GIA)</p> <p>EY have not yet concluded their work on valuations but note that there are outstanding queries to resolve on DRC valuations.</p> <p>EY will update the audit committee at the meeting on 22 September.</p>	<p>The outstanding queries on DRC valuations relate to EY investigating the methodology used by the Council’s valuers as a result of an issue highlighted in another of their audits. The Council has provided relevant information of the investigations and conclusions of its previous external auditors in this area. As in previous years the Council expects this to be noted as professional differences of opinion between valuers.</p> <p>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 (now NPS), 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.</p> <p>EY obtain valuation advice from their internal valuers on the suitability of the valuation approaches used by WHE.</p>
<p>2. Accounting for schools’ non-current assets</p> <p>The decision to exclude the assets from the balance sheet is in line with the Code and consistent with the Council’s approach for this category of assets.</p> <p>However, although these assets have been correctly excluded from the balance sheet there has been no progress in completing the legal transfer to the governing bodies of the schools.</p>	<p>As identified in the 2014/15 accounts the Council are in the process of transferring ownership of these assets, and are obliged to treat the assets as if ownership had already transferred. The Council has concluded that the inclusion of these assets, onto its balance sheet, would not present the users of the accounts with a true and fair view of the position for the year ended 31 March 2016.</p> <p>EY concur with the Council’s previous external auditors in that the judgement and accounting treatment applied is acceptable and the situation is fully disclosed within Note 44 “Critical Judgement in Applying Accounting Policies”.</p> <p>The Council’s solicitors are in contact with the relevant Diocese to resolve issues currently preventing transfer of the other assets.</p>
<p>3 Private Finance Initiative</p> <p>EY populated their Parallel PFI Model with assumptions from the Council’s Operate Model</p>	<p>PFI schemes and how they are accounted for relies on complex models which use a number of assumptions and estimation techniques. Following discussions between the Council’s</p>

EY Report – summary of points raised	Management Comment
<p>and identified some differences between the Operator model and the EY Parallel Model.</p> <p>The Council’s Operator Model calculations are in accordance with the CIPFA Code requirements for a service concession.</p> <p>They have not reported these differences as errors.</p>	<p>finance team and the EY technical expert, it has been confirmed that the differences in the models are due to applying different assumptions that are allowed within the Code.</p> <p>This arrangement is not new for the Council. The accounting treatment was agreed with PwC in 2009/10 and has been audited without any comment or adjustment in each subsequent year.</p>
<p>4. Minimum Revenue Provision (MRP) methodology change</p> <p>In common with many other local authority bodies in 2015/16 the Council has reviewed the basis on which they calculate the required “prudent” MRP amount. The change is proposed to assist with funding the budget gap which has been identified by the Council.</p> <p>The MRP adjustment is material and EY consider that there are risks around:</p> <ul style="list-style-type: none"> • Whether the weighted average life of the assets has been correctly calculated; • The treatment of Adjustment A • Whether the revised calculation of MRP is correct 	<p>The Council has been proactive in obtaining the EY opinion on the MRP methodology changes, commencing dialogue on this topic as early as December 2015. This has helped ensure that the basis of adjustment as contained in the Medium Term Financial Strategy was prudent.</p> <p>The item which EY has brought to Audit Committee attention reflects the application of PCC policy with regards to adjustments to capital expenditure from previous years creditor entries. In the past these credit entries have been immaterial in amount and therefore assigned a life of one in the MRP calculation to aid simplification of the calculation for future years. However, in the past two most recent years the total of these creditor adjustments have increased, and the Council has continued to apply its standard approach.</p> <p>Following discussion with EY no change is required in the 2015/16 accounts for this. The Council has now amended its calculation policy for future years with any credit adjustments over £50k to be matched to the life of the asset and original MRP charge.</p> <p>It should be noted that the previous external auditor had not raised this as a point of issue.</p>

Management Representation Letter

- 4.6 The Corporate Director: Resources, as Chief Finance Officer (S151), 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. EY also require this letter to be signed by the Chair of the Audit Committee. The draft letter is attached in Appendix 2 for review by Audit Committee.

Statement of Accounts 2015/16

- 4.7 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.
- 4.8 The draft Statement of Accounts was considered by Audit Committee on 29 June 2016 and has subsequently been the subject of external audit by EY.

- 4.9 Following the external audit, some presentational amendments have been made to the draft Statement of Accounts (presented to Committee in June), with the material presentational amendments shown in Appendix A of the ISA260 report.
- 4.10 The updated Statement of Accounts for 2015/16 is attached in Appendix 3 for formal approval by the Audit Committee.
- 4.11 At the time of reports publication to Committee, EY are finalising the audit of Statement of Accounts with some review areas to be completed. If there are further updates required to the version distributed with this agenda, then the revised Statement of Accounts and a schedule of updates will be tabled at the meeting.

5. CONSULTATION

- 5.1 Between 1 July 2016 and 11 August 2016, the Council's accounts have been subject to a statutory period for the exercise of public rights, where any person may inspect and take copies of the accounts and certain related documents. During this period Peterborough City Council electors have been able to ask the external auditor questions on the accounts, and are able to object to the accounts. None of these rights were exercised.
- 5.2 A clearance meeting was held 13 September 2016 where EY outlined the key findings of the audit to the Corporate Director: Resources, as part of his role as the Council's S151 Officer. The draft ISA260 report was discussed with the Council's finance team during the period 11 August to 13 September 2016.

6. ANTICIPATED OUTCOMES

- 6.1 To receive and note the "Audit Results Report - (ISA260) for the year ended 31 March 2016" from EY on behalf of the Council
- 6.2 To receive and approve the audited Statement of Accounts

7. REASONS FOR RECOMMENDATIONS

- 7.1 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."
- 7.2 It is a statutory requirement under the Accounts and Audit Regulations 2015.

8. ALTERNATIVE OPTIONS CONSIDERED

- 8.1 The Statement of Accounts have been prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom in compliance with the Accounts and Audit Regulations 2015. The only alternative option would be non-compliance with statute which is rejected.

9. IMPLICATIONS

- 9.1 There are no legal or financial implications of this report.

10. BACKGROUND DOCUMENTS

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

Council Constitution

11. APPENDICES

- Appendix 1 – ISA260

- Appendix 2 – Management representation letter
- Appendix 3 – Statement of Accounts 2015/16