

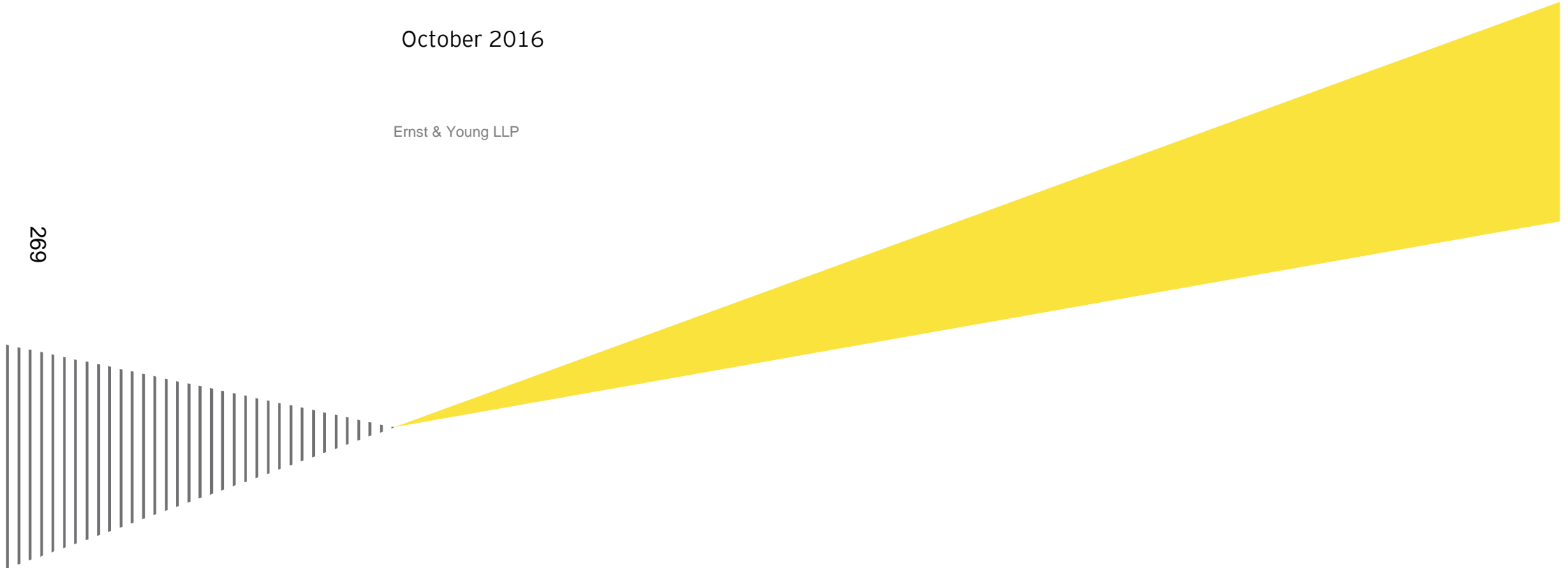
Peterborough City Council

Annual Audit Letter for the year ended 31 March 2016

October 2016

Ernst & Young LLP

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ‘Statement of responsibilities of auditors and audited bodies 2015-16’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure - If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Peterborough City Council (the Council) following completion of our audit procedures for the year ended 31 March 2016.

Below are the results and conclusions on the significant areas of the audit process.

| Area of Work | Conclusion |
|--|--|
| Opinion on the Council's: ▶ Financial statements | Unqualified - the financial statements give a true and fair view of the financial position of the Council as at 31 March 2016 and of its expenditure and income for the year then ended. |
| ▶ Consistency of other information published with the financial statements | Other information published with the financial statements was consistent with the Annual Accounts. |
| Concluding on the Council's arrangements for securing economy, efficiency and effectiveness | We concluded that you have put in place proper arrangements to secure value for money in your use of resources. |

| Area of Work | Conclusion |
|---|--|
| Reports by exception: | |
| ▶ Consistency of Governance Statement | The Governance Statement was consistent with our understanding of the Council. |
| ▶ Public interest report | We had no matters to report in the public interest. |
| ▶ Written recommendations to the Council, which should be copied to the Secretary of State | We had no matters to report. |
| ▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014 | We had no matters to report. |

| Area of Work | Conclusion |
|--|------------------------------|
| Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA). | We had no matters to report. |

As a result of the above we have also:

| Area of Work | Conclusion |
|---|--|
| Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit. | Our Audit Results Report was issued on 29 September 2016. |
| Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice. | Our certificate was issued on 20 October 2016, after we had concluded the work on the WGA return by the deadline of 21 October 2016. |

In January 2017 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Janet Dawson

Partner
For and on behalf of Ernst & Young LLP

Purpose



Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2015/16 Audit Results Report to the 22 September 2016 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 7 June 2016 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2015/16 financial statements; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 29 September 2016.

Our detailed findings were reported to the 22 September Audit Committee.

The key issues identified as part of our audit were as follows:

| Significant Risk | Conclusion |
|---|--|
| <p>Management override of controls</p> <p>A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p> <p>For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.</p> | <p>We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation.</p> <p>We did not identify any material weaknesses in controls or evidence of material management override.</p> <p>We did not identify any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.</p> <p>We reviewed capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised. Our testing did not identify any expenditure which had been inappropriately capitalised.</p> |

| Significant Risk | Conclusion |
|---|--|
| <p>Revenue and expenditure recognition</p> <p>Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.</p> <p>We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end.</p> | <p>Our testing has not revealed any material misstatements with respect to revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the Council's financial position.</p> |
| <p>Property, Plant and Equipment valuation</p> <p>The Council's previous auditor raised two issues in their annual audit letter relating to PPE valuations, re:</p> <p>Lack of reconciliation of Gross Internal Area (GIA) documentation. However, their work in this area concluded that the amounts on the valuation certificates were appropriate and no adjustments were required to the accounts as a result of this matter.</p> | <p>We completed our planned audit procedures and, for a sample of revaluations:</p> <ul style="list-style-type: none"> ▶ Concluded that we were able to place reliance on the work undertaken by management's valuation expert. ▶ Concluded that the basis of the valuations was in accordance with relevant guidance, in particular the 2015-16 Code of Practice on Local Authority Accounting. ▶ Concluded that the accounting treatment applied to changes in the valuation of property assets was appropriate. |
| <p>Accounting for schools' non-current assets. Your previous auditor identified matters in relation to 5 schools with a total netbook value of £9.5m. It is the Authority's view that legal ownership should reside with, and is in the process of transferring to, the governing bodies of the schools, who have substantive control over these assets. Therefore, the Authority does not have control over the assets and has not included these assets in the balance sheet. The Council's previous auditor was satisfied with the conclusions made by the Council not to recognise these assets but requested disclosure of this matter, including the net book value of the non-current assets of £9.5m, in a note to the accounts.</p> | <ul style="list-style-type: none"> ▶ We discussed the latest position on the school's transfer with the finance team, and understand that these schools are still in the process of transferring to the governing bodies. 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. 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. |

| Significant Risk | Conclusion |
|---|--|
| <p>Private Finance initiative</p> <p>The Council recognises on its Balance Sheet a PFI liability for a PFI agreement with IIC BY Education (Peterborough Schools) Limited which the Council signed in 2006 for the delivery of new and improved facilities and services for three secondary schools in Peterborough. The contractor will maintain these three schools and provide them with a range of other services such as caretaking, cleaning and catering for 30 years. One of the three schools has transferred to Academy status therefore the associated assets are not recognised on the Council's Balance Sheet. The value of the two schools which are recognised on the Council's Balance Sheet is £25.1m.</p> <p>The PFI liability is recognised at the same time as the PFI assets are recognised. It is measured initially at the same amount as the fair value of the PFI assets and is subsequently measured as a finance lease liability in accordance with IAS 17.</p> <p>The accounting entries are based on a complex range of assumptions via a PFI accounting model.</p> | <p>We completed our planned audit procedures and concluded that the Council's Operator Model calculations are in accordance with the CIPFA Code requirements for a service concession.</p> |

| Significant Risk | Conclusion |
|---|---|
| <p>Minimum Revenue Provision (MRP) methodology change</p> <p>In common with many other local authority bodies in 2015/16 Peterborough City 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 Council is currently applying MRP at a rate of 4% which is the previously accepted methodology for the capital expenditure incurred prior to 1 April 2008 which was funded by borrowing, and for supported borrowing undertaken from 2008/09 to 2010/11. The key element of the Council's revised approach is to link the MRP calculation to the weighted average life of these assets. In addition, the annuity basis is to be applied to unsupported borrowing post 2008.</p> <p>The MRP adjustment is material and we considered that there were 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 ; and ▶ Whether the revised calculation of MRP is correct. | <p>We completed our planned audit procedures and concluded that that the recalculated amount of MRP for 2015/16 is fairly stated.</p> |

| Significant Risk | Conclusion |
|---|---|
| <p>Assessment of the Group boundary</p> <p>Peterborough City Council has a number of joint arrangements which may necessitate the preparation of group accounts.</p> <p>The Council will need to identify and consider all of its relationships with its subsidiaries and other partners and assess the nature of these arrangements to determine whether they create functional bodies and other group entities which now fall within the group boundary and therefore require consolidating into the Council's Financial Statements. Group accounts have not previously been prepared by the Council.</p> <p>The review will need to consider the new accounting practices introduced in the 2014/15 CIPFA Code of Practice.</p> <p>There is a risk that associated group boundary changes may go undetected, and that the required disclosures are not made in accordance with the new standards.</p> | <p>We completed our planned audit procedures and we agreed with the Council's conclusion that it did not need to prepare Group consolidated accounts for 2015/16.</p> |

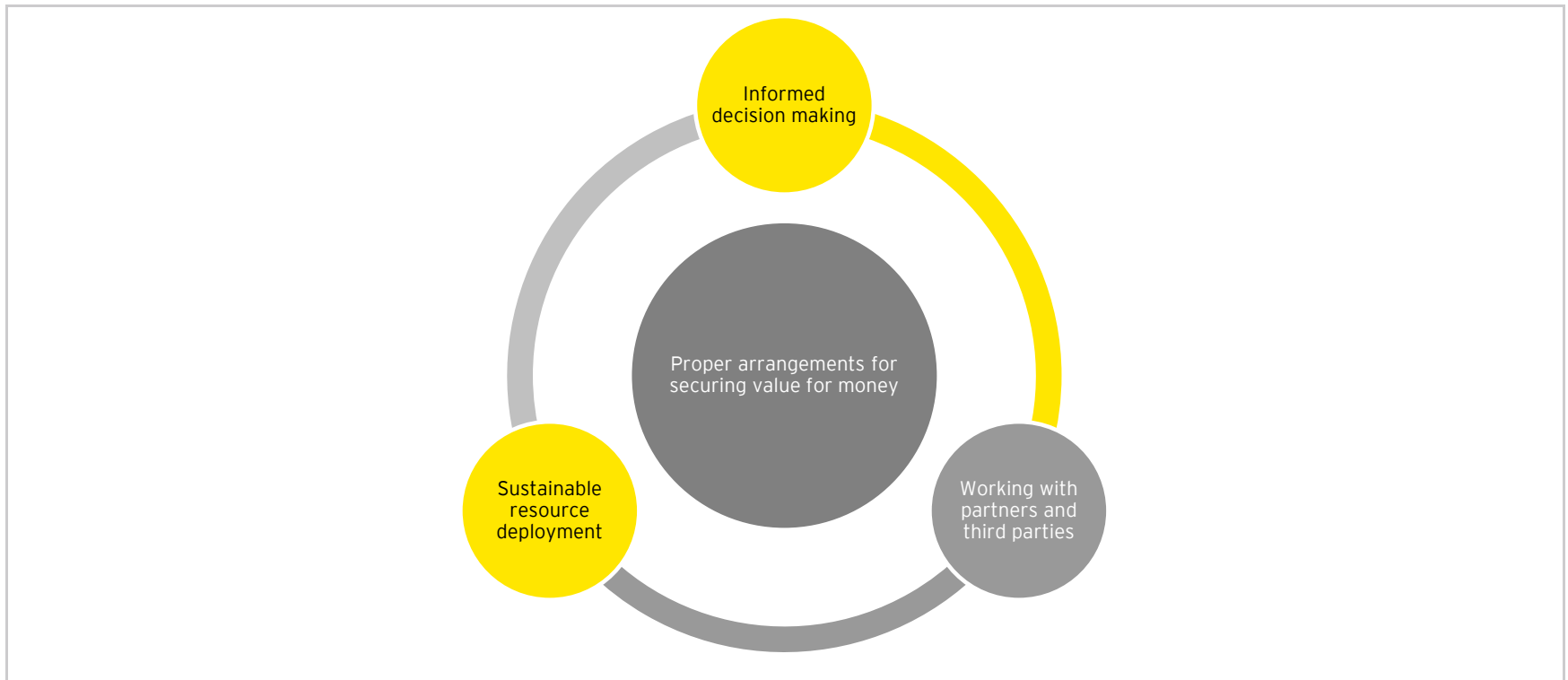
Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We issued an unqualified value for money conclusion on 29 September 2016.

We identified one significant risk in relation to our value for money conclusion. This related to the budget pressures faced by the Council.

We performed the procedures outlined in our Audit Plan and concluded that the Council had adequate arrangements in place.

As part of our work we considered the following areas and made the following observations:

Key Findings

Budget pressures

Councils are funded by grants from central government and locally raised revenue from council tax and business rates or from fees, charges, or other revenue generating activities. Since 2010/11 funding for Councils from central government has reduced by 37 per cent in real terms, and further reductions for the period 2016-17 to 2019-20 are likely.

The Council is taking action to address longer term financial resilience issues identified in the Medium Term Financial Strategy. The budget for 2016/17 is balanced; however, there are still some gaps to cover in subsequent years: £4 million in 2017/18, £24 million in 2018/19 and £31 million in 2019/20.

Achieving the 2016/17 budget will be reliant on savings plans of £24m being realised. £5 million savings are planned in each year as a result of changing the methodology of calculating Minimum Revenue Provision (MRP).

We reviewed the Council's 2016/17 budget and the medium term forecast, assessing the extent of the savings plans in place. This took into account the Council's historic record.

In 2015/16 the Council continued its track record of achieving its annual budget, delivering a surplus of £1m, along with approximately £25m of savings, and it has established a Grant Equalisation reserve with a balance of £12m, created to defer the impact of funding reductions. The general fund balance stands at £6m as at 31 March 2016, and total earmarked reserves at £30m.

The 2016/17 budget is balanced, through the use of efficiencies and income plans. Although it is still relatively early in the financial year, we assessed these as reasonably-based taking into account the Council's track record of delivering savings over the recent financial periods. While incrementally savings can become harder to achieve over time, the Council's performance in delivering its plans gives confidence that it can continue to do so.

We also reviewed the key assumptions in the budget and MTFs, which adequately took into account the economic environment at that time for business rate projections, and the forecast for reduced central government funding and the potential four-year settlement.

The budget gap for 2017/18 is £4m, 2018/19 £24m and 2019/20 £31m. Compared to a gross expenditure of approximately £520m per annum, and historic performance of closing the gap we judge this to be a manageable budget gap.

Therefore, based on the known information as at the end of the financial year, we assess the Council to have adequate arrangements.

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2015/16 financial statements from member of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

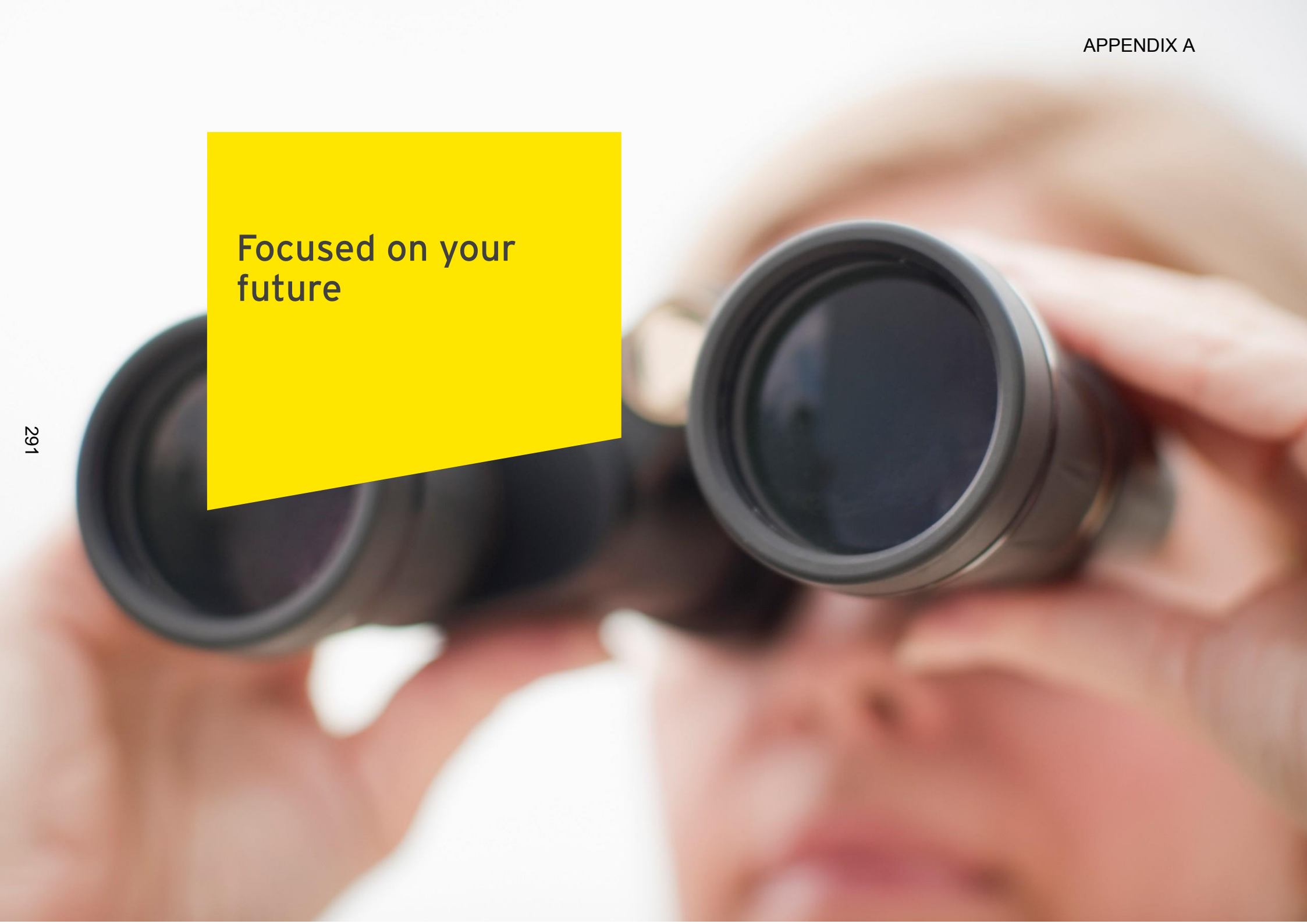
We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 22 September 2016. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

We have adopted a fully substantive approach and have therefore not tested the operation of controls. As part of our work, we obtain an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit is not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have not identified any matters to bring to your attention.

Focused on your
future



Focused on your future

| Area | Issue | Impact |
|-------------------------------|---|---|
| EU referendum | Following the majority vote to end the UK's membership of the European Union (EU) in the EU Referendum held on 23 June 2016 there is a heightened level of volatility in the financial markets and increased macroeconomic uncertainty in the UK. All three major rating agencies (S&P, Fitch and Moody's) took action on the UK Sovereign credit rating and, following the rating action on the UK Government. For entities in the public sector, there is likely to be an impact on investment property valuations if confidence in the wider UK property market falls; and the valuation of defined benefit pension obligations may also be affected. It is too early to estimate the quantum of any impact of these issues, but there is likely to be significant ongoing uncertainty for a number of months while the UK renegotiates its relationships with the EU and other nations. | Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of the referendum and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions. |
| Highways Network Assets (HNA) | The Code of Practice on Transport Infrastructure Assets (TIA Code) was first published in 2010 and updated in 2013. The key aim of this document was to improve the asset management of TIA. During 2016, this guidance has been renamed and updated, with the Highways Network Asset (HNA) Code, Guidance Notes and Accounting Guidance being published. Local Government has historically used depreciated historic cost (DHC) as the valuation approach for infrastructure assets. The introduction of the HNA Code will see this valuation basis change to depreciated replacement cost with effect from 1 April 2016. The change will be applied prospectively from that date, so Highways Authorities are not required to disclose comparative information. | <p>The impact on the Council's Balance Sheet will be a significant increase in the Net Book Value of Property, Plant and Equipment. The impact on the audit will also be significant, as auditors will need to obtain sufficient assurance over the material accuracy of the assets.</p> <p>We will work closely with the Council at both the local level, regarding system implementation, valuation procedures and accounting, and at the wider level through the continuation of our HNA Client Workshops.</p> |

| Area | Issue | Impact |
|------------|---|--|
| Devolution | <p>The UK has lagged behind other countries in decentralising its governance. But in recent years, 'localism' has gained momentum. Large parts of England have started to agree Devolution Deals, which transfer powers in policy areas such as housing, planning and transport, education, employment, skills, health and policing. If managed well, it could help stimulate local economies to achieve higher levels of job creation and growth; improve public service outcomes through better local coordination of resources and funding; revitalise local democracy through more accountable governance; and improve the sustainability of public finances.</p> <p>In March, the Chancellor published an offer to local authorities in East Anglia - to form an East Anglia Combined Authority covering Norfolk, Suffolk, Cambridgeshire and Peterborough. Communities and businesses in Cambridgeshire and Peterborough were consulted on the proposals.</p> <p>Negotiations between the Councils in the East Anglian region concluded that the interests of the region would be best met through two combined authorities - Cambridgeshire and Peterborough, and Norfolk and Suffolk.</p> <p>Cambridgeshire and Peterborough have now negotiated a new devolution deal, proposing the formation of a Combined Authority including: Peterborough City Council, Cambridgeshire County Council, Fenland District Council, Huntingdonshire District Council, East Cambridgeshire District Council, South Cambridgeshire District Council, Cambridge City Council and the Greater Cambridge Greater Peterborough Local Enterprise Partnership. This proposals remains subject to ratification by each Council.</p> | <p>The Cities and Local Government Devolution Act came into force on 28 March 2016. Orders and regulatory amendments relating to constitutional or electoral issues need to be in place by late 2016 to ensure that the combined authority can come into effect early in 2017 and the Mayoral elections can take place in May 2017.</p> <p>The Secretary of State must first make an Order for the creation of the combined authority and then seek consent to the draft Order from each authority. The draft Order will be considered by both Houses of Parliament before being made.</p> <p>In EY's report 'From Whitehall to Townhall Preparing for devolution to England's city regions' we look at progress so far and outline the factors that have driven success in winning more powers. We reflect on the readiness of different areas to make a success of devolution and speculate on the long-term impact on local government.</p> <p>The debate will continue for some time to come, and lessons will be learned along the way. Drawing on our experience of working with a number of local authorities and cities, we are committed to helping facilitate debate and sharing best practices to help local government deliver the best services and outcomes to their communities and citizens.</p> <p>We will also need to consider how Councils are preparing for the transition to the new arrangements, whilst maintaining 'business as usual,' for our 2016/17 Value For Money conclusion.</p> |

Appendix A

Audit Fees



Appendix A Audit Fees

Our fee for 2015/16 will be more than the scale fee set by the PSAA as reported in our Annual Results Report.

| Description | Final Fee 2015/16 £ | Planned Fee 2015/16 £ | Scale Fee 2015/16 £ | Final Fee 2014/15 £ |
|--|------------------------|--------------------------|------------------------|------------------------|
| Total Audit Fee - Code work: Note 1 | TBC | 117,408 | 108,533 | 144,710 |
| Total Audit Fee - Certification of claims and returns: Note 2 | TBC | 13,619 | 13,619 | 18,740 |

Note 1 - Audit Fee - Code work. We have reviewed our costs now we have completed our outstanding audit procedures. We reported in our Audit Results Report that we expected this additional fee to be no more than 10% of the scale fee. This additional fee will be £8,875, which is 8% of the scale fee. The additional fee covers the work involved in responding to the audit risks outlined in this report, and the issues discussed in our Audit Results Report presented to the Audit Committee on 22 September 2016. It includes an additional fee of £2,856 for the review of the change to the MRP methodology. The additional fee is currently subject to approval by Public Sector Audit Appointments Ltd (PSAA).

Note 2 - We have not commenced our work in this area. Our certification of the Housing Benefit claim will be completed to the 30 November 2016 deadline, and the final fee concluded at that time. We will report the results of our work and the final fee with you in our Annual Audit Letter.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

EY | Assurance | Tax | Transactions | Advisory

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ED None

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