

AUDIT COMMITTEE

Statement of Accounts 2018/19 30 October 2019

Report of Chief Finance Officer

PURPOSE OF REPORT

This report seeks to provide Members with an update of the progress of the external audit of the Council's 2018/19 Financial Statements, outlining the issues raised to date and those that remain unresolved.

This report is public.

RECOMMENDATIONS

The Audit Committee is recommended

- (1) That the report be noted and following the conclusion of the audit, the Chair, in consultation with the Section 151 Officer, be authorised to approve the Statement of Accounts and to sign the letter of representation.

1.0 REPORT

- 1.1 In accordance with the Accounts and Audit Regulations, the draft Statement of Accounts for 2018/19 were certified by the s151 Officer on 31st May 2019 and were made available for public inspection 31st May 2019.
- 1.2 The external audit of the Statement of Accounts commenced 10th June for an initial period of 7 weeks. On 16th July the Audit Committee date was rescheduled from 24th to 29th July to allow the external auditors additional time to substantially complete the audit. On 19th July the external auditors advised on a material error (2018/19 £14.8M, 2017/18 £15.6M) in the Statement of Accounts regarding the recharging of the Council's internal support services within the Comprehensive Income and Expenditure Statement (CI&ES).
- 1.3 Although the error is material, in that it could influence decisions that users make based on the financial information of the Council, it relates to internal accounting arrangements and has no impact on the Council's net reported financial position.
- 1.4 As materiality is used to drive the entire audit process and is calculated based on values within the CI&ES it was agreed that officers would rework and provide a revised Statement of Accounts and supporting working papers by 13th and 14th August respectively. External audit would then revisit their materiality calculations and identify

any additional work and the Audit Committee would be postponed until this additional work was complete.

- 1.5 The audit team returned 19th August and officers were advised on 30th August that the work was substantially complete, subject to an internal review process. Numerous progress requests and proposed revised Audit Committee dates were made by officers. On 2nd October officers received details of 40 outstanding queries many of which related to issues which had already been addressed, or working papers that had previously been submitted.
- 1.6 Although the majority of this outstanding work is now complete there remains a significant difference of opinion between officers and the external auditors regarding some of the Council's property valuations. Officers are working with the external auditors to address their concerns, however, until this issue has been resolved the Statement of Accounts cannot be approved and our external auditors have informed us there is a possibility that they may wish to qualify the Statements.

2.0 WORK OUTSTANDING

Property Valuations

- 2.1 The Council engages its Property Services Team to undertake all its property valuations. External Audit engaged their own valuer to review a sample of these valuations, raising a number of issues directly with the Property Services Team. These issues were answered in full by our Property Services Team (16th July).
- 2.2 Officers were notified (2nd October) that the answers received are not satisfactory and, in their opinion deviate from expected application of the valuation methodology.

External Audit Concerns

Car Park Valuations.

- 2.3 "The valuations have been made based on a capitalised net income basis however the extent of deductions made from the gross income, in our opinion, are insufficient to support the approach. Key deductions for e.g. management costs and operators profit margin do not appear to have been made which, in our view, results in an overstated net income for the purposes of the valuation and, consequently, an overstated asset value."

- 2.4 *Land Adjacent to Scotforth Cemetery.*

"Although the land is currently in use as agricultural land (with an existing tenant) the higher land value adopted is on the assumption that it can be sold with vacant possession as development land (assuming residential planning consent).

We consider this assumption to be unreasonable and Fair Value should reflect appropriate discounts for planning risk and the cost and time it would take to secure vacant possession."

Bus Station Land.

- 2.5 "We understand that, in valuing the land, the Authority team have reflected their ongoing discussions with United Utilities (UU) over compensation for a similar site. UU have offered £500k per acre whilst the authority's view of land is based on the valuation of car parks. As noted above we do not consider the car park valuations to be reasonable and so the application of this tone of values to the bus station land is questionable without additional support from comparable"

- 2.6 The external auditor has offered 4 potential options for resolution.

Option 1: Provide Additional Evidence to Support Our Assertions
2.7 Officers submitted additional information 23rd October which included extracts from the Royal Institute of Chartered Surveyors (RICS) guidance notes, consultation with neighbouring Councils and RICS.

Option 2: Obtain an External Third Party Valuation
2.8 The only purpose for undertaking this particular exercise and incurring additional cost (£10k+) would be if the Council's valuers considered that they needed to supplement their own expertise and experience in order to make a valuation, or if there was evidence that their work was compromised by pressure to overvalue. Having discussed this with our valuers we do not feel this option is appropriate.

Option 3: External Audit Undertake a Valuation for Audit Purposes
2.9 This valuation would be undertaken by the external auditor's valuation team at a cost to the Council circa £15K to enable them to estimate the error in the population. It is my current understanding this would not be available to Council officers and would solely be for external audit purposes.

Option 4: The Statement of Accounts Qualification
2.10 If we are unable to reach an agreement the external auditor will consider the need to reflect the difference in an amended audit report. If material, the report will sign off the accounts as true and fair "except for ..." the claimed misstatement, detailed in the Basis for Opinion section with a description and quantification of the financial effects.

2.11 Although there is a degree of reputational damage attributed with a qualified opinion there is no financial impact on the Council.

2.12 Our priority is to get the Statement of Accounts signed off without a qualified opinion and Officers are currently engaged with External Audit to seek a suitable resolution

3.0 REQUEST FOR ADDITIONAL AUDIT FEE

3.1 The Council will incur an additional audit fee in relation to the audit of the Statement of Accounts. As the audit has yet to be concluded the exact amount has yet to be discussed with Officers and agreed with Public Sector Audit Appointments (PSAA). However we would expect that fee to be limited to the additional work incurred.

4.0 KEY ISSUES

2018/19 Statement of Accounts

4.1 The ISA 260 Report has not identified any adjustments affecting the Council's reported net financial position and although issues remain outstanding these are expected to be resolved and an unqualified opinion issued.

4.2 The audit highlighted a number of adjustments to both the core financial statements and explanatory disclosure notes, these have been agreed to ensure full compliance with accounting practices and to improve the presentation of the financial statements. The most significant issues relate to:

Adjusted Misstatements

Internal Trading (Recharges) £14.8M (2017/18: £15.6M)

- 4.3 This error relates to a historic treatment of the way in which the Council's recharges its internal support and other services. This resulted in an overstatement within the CI&ES for both 2018/19 and 2017/18 although the net expenditure is reported correctly.

Financing and Investment Income & Expenditure: £6.2M

- 4.4 The Council's General Fund recharges PWLB loan interest to the Housing Revenue Account (HRA). This led to an overstatement of both income and expenditure in line with the issue reported at paragraph 4.3. In addition accounting transactions reflecting Pensions Interest Costs and Return on Assets were netted off each other at the request of external audit. Neither of these adjustments have any impact on the Council's reported net expenditure

Investment Property £1.8M

- 4.5 A clerical error resulted in the value of one investment property being overstated. The recognition of valuations in respect of investment properties are adjusted out through the Movement in Reserves Statement (MiRS) and have no impact on the General Fund balance.

Taxation and Non Specific Grant Income & Expenditure: £2.9M (2017/18 £2M)

- 4.6 The statutory adjustments required to derive a retained business rates figure have now been disclosed as adjustments to income although this has no impact on the Council's reported net expenditure.

Short Term Investments: £9.1M

- 4.7 Two investments held by the Council at 31st March 2019 were redeemable within 30 days and as such were reclassified as Cash & Cash Equivalents.

Debtor & Creditor Balances: £4.7M (2017/18 £4.7M)

- 4.8 Historic Collection Fund debtors and creditor balances in relation to the 2016/17 Business Rates Levy were overstated by an equal amount.

Short Term Creditors £1.1M

- 4.9 Accrued PWLB loan interest within creditors should more properly have been disclosed within Long Term Borrowing to comply with Financial Instruments disclosure requirements.

- 4.10 A further number of low value adjustments have been made and are listed within the ISA 260 Report.

Unadjusted Misstatements

Long Term & Short Term Accrued Interest £1.1M

- 4.11 The £1.1M adjustment outlined at paragraph 4.9 was made against long term borrowing so that the overall liability presented in the Balance Sheet was the outstanding principal plus loan interest. The interest was payable within 12 months.

Internal Items of Internal Income & Expenditure £1M

- 4.12 A residual amount of internal trading remains overstated within the CI&ES. Additional work by officers means this value may now be lower than currently reported.

- 4.13 Impact of McCloud/ Sargent Judgement
The impact of this judgement remains uncertain and has been disclosed within the Statement of Accounts as a Contingent Liability

5.0 VALUE FOR MONEY OPINION

- 5.1 Although a couple of minor items remain outstanding no significant issue have been raised with Officers and we expect the external auditor to issue an unqualified opinion.

6.0 OPTIONS AND OPTIONS ANALYSIS

- 6.1 The Accounts approval process represents an opportunity for the City Council to consider the outcome of external audit, to ensure that its financial reporting is appropriate and take any action as needed. Given the results of the audit, no alternative options are put forward, but the Committee could make supplementary recommendations regarding any matters arising.

7.0 CONCLUSION

- 7.1 Subject to the resolution of the outstanding valuation issue, the findings of the audit have been varied with the majority reflecting historic accounting treatment and processes. Recommendations have been made for the Council's future financial reporting and VFM arrangements, many of which were already known and work on them is in progress.

CONCLUSION OF IMPACT ASSESSMENT

(including Health & Safety, Equality & Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing):

No implications directly arising.

LEGAL IMPLICATIONS

The Accounts and Audit (England) Regulations 2015 apply for accounts and reports relating to the financial year 2018/19, and completion in accordance with International Financial Reporting Standards is required in order to comply with both the statutory framework established by the Accounts and Audit Regulations, and proper accounting practices required by Section 21(2) of the Local Government Act 2003.

FINANCIAL IMPLICATIONS

None of the issues raised during the course of the audit, or those that remain outstanding will have any impact on the financial outturn previously reported to Members.

However, Members should be aware that two of the proposals put forward by the External Auditors to resolve the valuations issue would involve additional cost to the Council of between £10K and £15K. In addition the Council will incur additional audit fee, however this has yet to be discussed or agreed.

OTHER RESOURCE IMPLICATIONS, such as Human Resources, Information Services, Property, Open Spaces

No implications directly arising.

SECTION 151 OFFICER'S COMMENTS

This report forms part of the Chief Finance Officer's responsibilities, under his role as s151 Officer.

DEPUTY MONITORING OFFICER'S COMMENTS

The Deputy Monitoring Officer has been consulted and has no further comments

BACKGROUND PAPERS

None

Contact Officer: Paul Thompson
Telephone: 01524 582603
Email: pthompson@lancaster.gov.uk
Ref: