# Audit and Standards Committee Report

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| **Report of:** | Ryan Keyworth |
| **Date:** | 22 September 2022 |
| **Subject:** | Formal response to audit (ISA 260) recommendations |
| **Author of Report:** | Jane Wilby / Ruth Matheson |
| **Summary:** | The purpose of this report is to provide members of the Audit and Standards Committee with an update on progress to consider and implement Ernst & Young's prior year recommendations, following the audit of the Council's 2019/20 and 2020/21 Statement of Accounts. |
| **Recommendations:** | The Audit and Standards Committee is asked to note management's response on progress made to Ernst & Young's prior year recommendations. |
| **Background Papers:** | None |
| **Category of Report:** | OPEN |

## Statutory and Council Policy Checklist

| Financial Implications |
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| NO |
| **Legal Implications** |
| NO |
| **Equality of Opportunity Implications** |
| NO |
| **Tackling Health Inequalities Implications** |
| NO |
| **Human Rights Implications** |
| NO |
| **Environmental and Sustainability implications** |
| NO |
| **Economic Impact** |
| NO |
| **Community Safety Implications** |
| NO |
| **Human Resources Implications** |
| NO |
| **Property Implications** |
| NO |
| **Area(s) Affected** |
| None |
| **Is the item a matter which is reserved for approval by the City Council?** |
| NO |
| **Press Release** |
| NO |

# AUDIT AND STANDARDS COMMITTEE – 22 SEPTEMBER 2022

## Formal Response to Audit (ISA 260) Recommendations

## Purpose of the Report

1. The purpose of this report is to provide members of the Audit and Standards Committee with an update on progress to consider and implement Ernst & Young's prior year recommendations, following the audit of the Council's 2019/20 and 2020/21 Statement of Accounts.

## Ernst & Young Audit Results Report

2. Each year Ernst & Young (EY) carry out their annual audit of the Council's statement of accounts and make recommendations (observations) in their Audit Results (ISA 260) report that is reported to Members of the Audit and Standards Committee.

3. Such recommendations are for officers to implement within EY's suggested timeframes, which EY monitor and regularly update the Committee on the Council's progress.

4. Ernst & Young presented their 2020/21 Audit Results report to the Audit and Standards Committee on 20th January 2022, which was finalised and reissued alongside EY's opinion on 1st March 2022.

5. The Audit Results report listed fifteen open observations, both from 2019/20 and 2020/21. The nine open observations relating to 2019/20 remained open at the end of the 2020/21 audit, as EY had reported these at the end of the 2020/21 financial year and acknowledged that officers had little opportunity within the timescales to take action on the recommendations in time for EY to report in 2020/21.

## Progress Update

6. This report is the Council's internal update on progress in implementing the recommendations. EY will also report separately on our progress and recommend whether the observations remain open or if further action is required. At such time EY will also inform the Committee of any observations they identify during their upcoming audit of the 2021/22 statement of accounts.

7. The fifteen open observations as reported following the 2020/21 audit are included within **Appendix 1** and have been rated as either "low" or "moderate" by EY. Appendix 1 includes management's updated response to each of the recommendations.

## Financial Implications

8. There are no direct financial implications arising from the recommendations in this report.

## Equal Opportunities Implications

9. There are no specific equal opportunities implications arising from the recommendations in this report.

## Property Implications

10. There are no property implications arising from the recommendations in this report.

## Recommendations

11. The Audit and Standards Committee is asked to note management's response on progress made to consider and implement Ernst & Young's prior year recommendations.

**Appendix 1**

Low - A weakness which does not seriously detract from the internal control framework. If required, action should be taken within 6–12 months.

Moderate - Matters and/or issues considered to be of major importance to maintenance of internal control, good corporate governance or best practice for processes. Action should be taken within six months.

| **Observations in 2019/20** | | |
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| **Area** | **Observation** | **Management Update** |
| Property Plant and Equipment | The accounting of capital balances within the financial statements is a complex area which involves a number of judgements and estimates. It is also a significant balance within the financial statements. Whilst we note that the property services and finance teams have provided a significant amount of time facilitating the audit of these balances we have identified the following observations:<br>• There are some assets that have been included in the asset register on a portfolio basis. However, the nature of the assets are different and therefore they should be separated out and revalued individually. In addition, during our review of some of these assets we have identified that the valuations are contingent on future events or decisions by members that should not be taken into account unless there is robust evidence to support otherwise.<br>• A number of assets have been identified in the current | Significant progress has been made to rectify the issues observed in 2019/20:<br><br>• In 2020/21, Property Services reviewed the ground rent portfolios and separated out some categories of asset into new portfolios so that they could apply a more tailored valuation approach to those assets and as a result the value of assets within each portfolio are now more comparable.<br><br>• Furthermore, assets within certain portfolios were further split into more granular categories in order to apply different rental yields etc. which are more representative of each class. For example, the commercial portfolio was further split into categories including offices, hospitality, retail, industrial etc. |

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| | year where they have had nil values previously, or the assets classification was previously incorrect.<br>• In our review of beacons we identified several instances where the variants used for type of property were not consistent with our expectations. This was due to additions or assets that had fallen outside of the normal valuation cycle.<br>• We have identified that a number of the council's assets are overvalued due to a formula error when applying the physical depreciation factor.<br>• Consideration should be given to a more thorough review of the balances being included in the financial statements to ensure that they logically make sense and are code compliant, especially where figures are received directly from the property team. This should also be extended to manual adjustments made to the fixed asset register to meet the presentational requirements of the PPE note. | • Assets with nil value are now reviewed on a more regular basis and at least annually, to determine whether they should be valued or archived. Furthermore, grouping more low value assets into portfolios has allowed us to better focus on reviewing the remaining higher value assets for issues such as incorrect asset categorisation.<br><br>• Work to review dwellings which have fallen outside the normal valuation cycle is ongoing, with a view to ensuring that these are brought into the cycle and any missing or incorrect data associated with these properties is rectified.<br><br>• The formula error affecting assets valued on a Depreciated Replacement Cost basis was a one-off error, but since 2019/20 we have implemented more rigorous quality assurance checks for Property Services' valuations, particularly those carried out on a spreadsheet or portfolio basis, to ensure that similar errors are identified and fixed prior to publication of the accounts. |

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| Public Finance Initiatives | During our testing of PFI we have held a number of conversations with management over the course of the year, including a number with our PFI specialist. Accounting for PFIs and the underlying models can be complex. Therefore we recommend that management ensures that they have members of the team who fully understand the models and related Code guidance to ensure that too much reliance is not placed on the audit process to identify errors in the models in the first instance. | Officers agree with EY that PFI accounting models are very complex. As a result of staff changes at the time of reporting, additional members of the accounting team are now trained and up to date with the Code guidance and PFI models. |
| Supporting information for key judgements | During our testing of provisions we identified instances where judgements applied by management were not wholly supportable. For example, an additional adjustment of 49% was applied to the NDR provision in the current year without sufficient evidence to support this being appropriate. Whilst we have been able to undertake alternative procedures to gain reasonable assurance over the accuracy of the provision, management should ensure that all estimates and judgements are robustly evidenced and supported. | Estimates and provisions used within our accounts are based on judgement and we have continued to look to improve the information to support our judgements and the information required as audit evidence.<br><br>The NNDR (Business Rates) appeals provision raised by EY, is based on guidance available, which we then review and judge to ensure it is reasonable. We felt the provision was too high so made a judgement to reduce by 50%. We accept this was not sufficiently evidenced but based on officer judgement.<br><br>Officers are currently in the process of applying for |

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| | | the additional information that the Valuation Office Agency (VOA) has now started to supply for the 2017 list appeals. This will provide better insight into outstanding and settled appeals, and feed into the calculation for the required provision. |
| Debtors and creditors listings | Consistent with the prior year we have experienced difficulties in obtaining a list of year end balances at the transaction level for debtors and creditors, with numerous iterations being received before being able to select our samples. Whilst we understand that the listings are compiled from various sources, additional review procedures should be put in place to ensure that information being provided for audit is complete, accurate and represents the transactions outstanding at the end of the financial year. | We have continued to work with accounting and service teams to ensure that they provide complete listings down to transaction level and matched with source data.<br><br>Significant improvements to the debtor and creditor listings provided was seen in 2020/21 and further work has been undertaken by teams to improve during 2021/22. |
| Senior officer remuneration and related party transactions | During our audit work we identified a number of errors and omissions in the compilation of the senior officer remuneration and related party transactions notes. Additional procedures should be put in place to ensure the completeness and accuracy of the information to be included in the financial statements. Councillors and Officers should also ensure that all potential related parties are disclosed on their declaration of interests. | Following the audit finding we have worked with the necessary teams, including HR and Democratic & Member Services, to improve the completeness and accuracy of the data collection and review processes. |
| School balances | Consistent with the prior year we have experienced some difficulties in obtaining evidence in relation to | Prior to 2020/21 the statutory deadline for closing the accounts had been brought forward to May, |

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| | school balances included within the financial statements. This has meant that in a number of instances we have been required to perform alternative procedures to gain assurances over the material accuracy of balances included in the financial statements. | with Councils encouraged to use estimates to help achieve this much-reduced reporting timetable. This shorter timeframe, together with Schools' Easter break fixed at the start of April meant that Schools had agreement to use estimates and accruals for any remaining transactions in month 12, which meant additional work had to be undertaken to provide evidence of school balances and the reason for differences.<br><br>For both 2020/21 and 2021/22 the statutory deadline was extended to July, due to the ongoing working pressures associated with COVID. This allowed actual balances to be used for Schools rather than a reliance on estimates for the Statement of Accounts, resulting in better assurance and accuracy of balances included.<br><br>However, if in future years the deadline reverts to May, the use of estimates may need to be relied upon again or other options considered within the constraints of the statutory timetable. |
| Starters and leavers testing | During our testing of starters and leavers we identified:<br>• a contract for a new starter which shows the employee signed it on the 26th November 2019, however the | Following the audit finding we have worked with HR and Payroll to improve processes and ensure new robust review / assurance steps are now in |

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| | employee started their role on the 14th October 2019.<br>• a new starter who commenced work and had been paid prior to a contract being issued and signed. | place. |
| Exit packages | During our testing of exit packages we have not been able to obtain appropriate audit evidence to support the agreement date for exit packages. The majority of this evidence is held in paper format in the SCC office building. Given restrictions in place due to the pandemic we were unable to evidence to support the inclusion of balances within the financial statements note. | During the audit in 2020, COVID restrictions applying to Council offices and audit fieldwork meant that where information was held in paper format, this was sometimes not accessible. Every effort was made to provide alternative information to assist with audit requirements.<br><br>Since the 2019/20 audit, all exit packages approved by Chief Officer Panel (COP) are now held and managed electronically, which is used by officers to prepare the termination benefits note. Sign-off by the employee is also completed electronically and both are available as audit evidence. |
| Expenditure/ payables cut off | During our testing of expenditure and payables cut off and unrecorded liabilities testing we identified a number of errors where transactions are not being recorded in the correct financial year. In all instances, 12 months of expenditure had been included in the financial statements, however, the accruals concept had not been applied, with the transactions being recorded on a cash basis. Management should ensure that all transactions | Where estimates are difficult to calculate in a timely or cost-effective way, the practice has been to include 12 months of rolling actuals in each annual accounts (e.g. for utilities costs).<br><br>This has been a widely used and accepted practice across the sector for many years and one we would prefer to continue to follow as previously |

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| | are recoded in the year where the goods or services have been received. | accepted practice.<br><br>In response to the recommendation, the team will continue to look at ways to use accruals to calculate spend when material and feasible. |
| **Observations in 2020/21** | | |
| Debtors | We sampled an item in debtors existence of value £572k. On further inspection SCC had been debiting this account code with pay advances, but credited the receipts to a different code.<br><br>The two codes net off within the statement of accounts but in reality only 77k was actually outstanding. This approach leads to additional administrative burden to compare the two codes each year and also produces artificially high balances from which we identify our samples.<br><br>SCC have agreed to undertake a consolidation exercise to transfer the credits to the correct code, reducing the balance on each code. | The audit identified that debit and credit balances for pay advances were being posted to separate codes and that officers then consolidate as part of their regular reconciliations.<br><br>We are working to simplify our processes and ensure a net outstanding balance is shown within the finance system. Work is underway with Payroll to reconcile the related transactions and officers will transfer the credits to the one code when all work with Payroll is complete. |
| IFRS 16 preparedness | The Authority does not yet have a robust system in place to ensure they capture trigger events which would require them to assess lease liabilities. | IFRS 16 is a new standard for accounting for leases. Since the recommendation, the implementation has been deferred until 1st April 2024; the standard will apply for the first time in the |

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| | Based on discussions, we note that the Authority will not be in a position to implement a software solution or "system" by 1 April 2022 to account for leases which would automatically flag such changes as they occur, however, there will be reliance on the Property Services department to notify Finance of any such triggers that may be present. The Property Services department will be assisting the finance team in reviewing their leases each year. At current, this is the process the Council will follow in this regard. | 2024/25 financial statements.<br><br>With an additional 2 years to prepare for implementation, we continue with our preparations, working closely with Property Services.<br><br>As part of this work, we are considering software solutions to assist with the accounting for leases. As electronic systems become available nationally, we will review whether any provide a more reliable and cost-effective approach than the current one.<br><br>Even with a system, there will continue to be a need to manually record lease amendments and work is underway to develop procedures across multiple teams to capture this information. |
| Investment Properties | Discussions held between management and the EY internal specialists in relation to small format advertising space, it became clear that the Council retains the right to use up to £0.5m of space per annum, The valuation of the associated asset capitalised in recognition of the advertising space does not take into account the space available for Council use. We have concluded that the asset is not materially misstated, but have included a range by which the asset may be understated in Section | During 2021/22 the Accounting team and Property Services reviewed the operational element of the small format advertising contract.<br><br>For the 2021/2022 accounts a valuation has been included on the balance sheet. We have engaged early with EY and their internal specialists to evidence the valuation method used and are currently liaising with EY to obtain agreement. |

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| | 04 of this report.<br><br>Management should ensure that the 2021/22 valuation for this advertising space includes all of the space that is retained by the Council as per the contractual arrangement. | |
| Members Interests | Our work identified transactions with two previously undisclosed related parties. These related parties were not disclosed by members on their annual declarations.<br><br>Management should introduce checks to be performed to ensure that members declarations are complete. | As part of the 2021/22 accounts officers carried out additional checks as recommended by EY, including conducting Companies House checks for each Member to ensure all interest disclosures are complete.<br><br>Additionally, we have liaised with Legal and Democratic & Member Services to improve the declaration process for Members, including:<br>• Further training, for example the Ethical training provided.<br>• Updates for Members to ensure awareness of the legislation and the requirements to complete the required forms.<br>• Monthly newsletters – each month the newsletter reminds Members to consider their declarations and whether any updates are needed. The newsletter also contains links that easily leads Members to the required areas for updating. |

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| Financial Statements Closedown Process – Quality Assurance | In disclosure note 7 we noted adjustments with no impact on the primary financial statements that were significant in their value. Although we have not listed these in the schedule of corrected misstatements, as they are of a disclosure nature only, management should ensure that the process of compiling the financial statements includes controls to reduce the likelihood of material misstatements of a disclosure nature also. | In 2020/21 a small number of disclosure errors in notes to the accounts were picked up by our review processes, some of which were found soon after publishing the draft accounts. Officers raised these with EY and corrected within the final accounts.<br><br>The timetable for closing the accounts and publication can be challenging, however, for 2021/22 we extended the review and proofreading time of the accounts closure timetable. This allowed officers to thoroughly review and amend as appropriate, prior to approval and publication. |
| Leases | In our substantive testing of leasing arrangements the council was unable to provide us with the original copy of one lease with a commencement date in 1934, assumed lost. Clearly this cannot be rectified, but it should be emphasised that leasing document should be retained for all new leases. | We accepted the audit finding that the evidence required was not available for one historic lease sampled.<br><br>As highlighted in the observation "IFRS 16 preparedness" above, preparation work for this new standard is highlighting the importance of maintaining comprehensive leasing information and we are working with Property Services to improve the completeness of our documentation. |