Audit and Standards Committee Report

Report of:	Philip Gregory
Date:	21 March 2024
Subject:	Formal response to audit (ISA 260) recommendations
Author of Report:	Clair Sharratt / 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 2021/22 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
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 – 21 MARCH 2024

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 2021/22 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, which is reported to members of the Audit and Standards Committee.

3. These recommendations are for management 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 2021/22 Audit Results report to the Audit and Standards Committee on 9th March 2023, which was amended and reissued to the Audit and Standards Committee on 21st September 2023. EY have yet to issue their opinion and whilst the accounts remain open, their 2021/22 Audit Results report is always subject to further change.

5. The Audit Results report listed thirty-one observations, both from 2020/21 and 2021/22. Sixteen open observations related to 2021/22 and of the fifteen observations relating to 2020/21, only three remained open at the end of the 2021/22 audit.

Progress Update

6. This report is the Council's internal update on progress in implementing the audit recommendations. EY will also report separately on progress made and recommend whether the observations remain open or if further action is required. As EY had reported their results at the end of the 2022/23 financial year, it should be acknowledged that officers had little opportunity within the timescales to take action on the recommendations for implementation in the 2022/23 Statement of Accounts (statutory deadline 31st May 2023), with some actions falling into the current 2023/24 financial year.

7. The nineteen open observations as reported following the 2021/22 audit are included within **Appendix 1** and have been rated as "low", "moderate" or "high" 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

High - Matters and/or issues are considered to be fundamental to the mitigation of material risk, maintenance of internal control or good corporate governance. Action should be taken either immediately or within three 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.

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

Observations in 2020/21		
Area	**Observation**	**Management Update**
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. 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. Management have stated: Implementation of IFRS 16 has now been delayed until 1 April '24, meaning we will	IFRS 16 covering lease accounting will be implemented from 1st April 2024 onwards (2024/25 accounts). We continue to work closely with Property Services, Schools and others across the Council to use our best endeavours to comply materially with its requirements. Progress has been made refreshing internal communications, identifying all active leases and gathering lease data. The Council is currently working with our asset register provider (Civica), to upgrade and migrate to their new system. The new asset register, which includes a leasing module that meets IFRS 16 requirements, is due to be implemented in September 2024. Along with an electronic system,

Page 39

	need to apply the standard for the first time in the 2024/25 accounts. Therefore, we have a further 2 years to prepare for implementation, which may include sourcing a software solution to assist with accounting for leases.	there will continue to be a need to manually record lease amendments and so we are in the process of establishing procedures across relevant teams to capture this.
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 an authority of this size with multiple directorates feeding in information for consolidation, the absolute elimination of errors is not feasible, particularly with a small core finance team. We note that the financial statements presented for audit in 2021/22 contain fewer errors and have benefitted from additional senior review time built into the timetable. However, the core finance team remains stretched and our report does contain a higher number of reporting issues and errors than we would expect; management should continue to seek improvements in the closedown process.	The timetable for closing the accounts and publication can be challenging, with the statutory deadline reverting to 31st May for the 2022/23 accounts. We welcome this recommendation to highlight the importance of protecting the review and proof-reading elements of the accounts closure timetable. Our review processes, during the closure of the accounts and after, have continued and where improvements or errors have been identified we have raised with our external auditors and corrected if material.

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 are recoded in the year where the goods or services have been received. We continue to report the in-year impact of this practice and would highlight whether there is a significant impact through our reporting of unadjusted errors.	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). This has been a widely used and accepted practice across the sector for many years. If this approach is no longer acceptable to external audit, then the team will look at ways to use estimates and accruals to calculate the annual spend, noting that this may be less accurate with judgements open to audit challenge, when they compare these estimated to the later actuals. It will also result in more than 12 months expenditure being included in one accounting period whilst we make the change, which is arguably misleading. We would prefer to continue with our previously accepted practice.
Observations in 2021/22		
PPE Valuations – Inputs	The work of our valuation specialists identified a number of errors in the inputs of valuations made in the year. These included: ➢ yields on car parks being significantly too high for the asset type being valued; ➢ Spreadsheet formulae being incorrect;	The audit fieldwork has been challenging in this area where the EY Real Estates team didn't begin its enquiries of our Property colleagues until late December 2022. Each year this then impacts on the valuation timetable of work for the coming year.

	➢ "surplus" nursery valuations being based on variables that are irrelevant to the valuation of the building; ➢ Valuations for schools not being updated to reflect capital works since the previous valuation; ➢ Incorrect BCIS build rates being used; and ➢ Incorrect site areas in calculations. Attention should be given to review the inputs being used in the valuation process.	As observations were raised during the 2021/22 audit, audit adjustments were implemented to correct the issues flagged with the valuations. During the 2022/23 valuation process the Property Services team continued to take into consideration EY's recommendations where possible depending on timescales. For 2023/24 the Property Services team will continue to implement EY's recommendations, enhancing their own quality assurance process. The asset portfolio is significant in size, both in terms of value and volume, and is largely made up of professional valuations which are subject to various judgements, estimation uncertainty, and information often not available at the time of the accounts preparation. We continue to work closely with our experts in Property Services to appraise what factors are appropriate in making reasonable judgements and review valuation approval processes to check for formula errors.
Related Parties	As set out in Section 4, our work comparing the various interests held by members to the disclosure made by	As part of the 2022/23 accounts officers carried out additional checks as recommended by EY,

	management in the financial statements identified eight related parties that had not been included. Two of these related to where the member had not made the adequate disclosure and six where the disclosure had been made however management did not capture this in their processes to create the required disclosures. Management should investigate how declared interests were omitted from their disclosures and act accordingly whilst reminding members to provide full declarations of interest and updating when circumstances change.	including conducting Companies House checks for each Elected Member to ensure all Register of Interest disclosures were complete. The Accounting team have also reviewed its own processes to ensure all declarations are included in the disclosure. We will continue to liaise with Legal and Democratic & Member Services to improve the declaration process and see how checks can be put in place to provide assurance.
Bank Reconciliation	We identified significantly higher bank lodgements at the year-end than the Council would expect, including some a year old. A number of these items should have been matched and the income reflected in the financial statements. Although we understand the reasons that these were not matched, this presents a risk that the financial position is misstated. Management have presented an updated position in October 2022 which shows the majority of items have since been cleared.	It is the responsibility of budget holders to ensure that transactions are entered in the general ledger to match entries paid/received to the bank account. However, the Treasury team has actively engaged with and assisted services to meet this requirement. In 2022/23 more user-friendly and timely information was published and distributed to budget holders, along with detailed guidance and regular communication / alerts to promote and support the process. Following the recommendation, a new policy is being developed to enable Treasury to act if items are unmatched

		beyond an agreed period. Currently the Treasury team had either matched or transferred items to a holding suspense account for reinvestment, with only current year items now shown as outstanding.
PPE Valuations – Useful economic lives	The work of our valuation specialists has identified that management have utilised a blended UEL approach for Specialised Assets valued under the depreciated replacement cost method. This has led to obsolescence being overstated for a sampled asset and potentially for other older assets. Management should consider whether a more tailored UEL should be applied to different asset types.	It was not feasible to implement a wholesale change to the valuation process prior to the 2022/23 year end, given the tight deadlines. Property Services experts have reviewed their approach to Useful Economic Lives in DRC specialist assets and are due to implement in 2023/24.
General Ledger Controls	Upon inspection the GL transaction data for interim and year end was incomplete causing variances in the completeness analysis when comparing the TB movement to the GL transactions. This was driven by missing journals when the data was downloaded from the system before the GL had been closed. This has led to inefficiencies in the audit process to identify the cause of the issues which led to further delays in us being able to select some of our samples. Controls should be introduced to ensure checks are made on the inclusion of relevant codes.	As soon as omissions were identified, controls were immediately put in place to improve our process for compiling the data requested by EY. From 2022/23 onwards, we only downloaded the monthly journal listings after the Systems & Training team had confirmed that the general ledger was closed for the month, this ensured that no transactions were omitted. For EY's benefit we have also added a summary sheet to the journal download template which includes the total debits and credits and the date & time of the last transaction in the report. To

		provide further assurance, at year-end we checked the finance system for each month to ensure that no additional transactions were posted after the date & time noted in the original journal downloads.
Termination Benefits	Due to lack of understanding of the requirements of the reporting framework, exit packages funded from the HRA had not been disclosed in the Financial Statements. This note is sensitive and thus any errors or omissions require amendment, management should ensure that those responsible for compiling disclosures within the financial statements are aware of the requirements.	As soon as omissions were identified, an audit adjustment was transacted in the 2021/22 Statement of Accounts. This amendment has been through EY's review process and once the audit opinion is issued the amended accounts will be published. The new member of the team is now fully briefed on the Code guidance and all HRA funded exit packages have been disclosed in 2022/23.
Provision of supporting documentation - payroll	Management have struggled to obtain the supporting information for the staff included in the Officers' Remuneration disclosure. This applies to members of staff working for schools who have their payroll run by Capita as well as Schools who run their own payroll. We have also encountered issues in obtaining information from payroll providers to support our testing of Starters and Leavers. Management should work with schools to obtain the supporting documentation for the Officers Remuneration note as part of the closedown timetable, rather than wait for items to be selected in our sample.	Following the audit finding we are working with Capita and Schools to improve processes and ensure that year end information and supporting documentation is provided. We plan to engage with both Capita and Schools early to clarify both EY's and our annual accounting requirements and that audit evidence is provided in a timely manner. However, we will ensure we work to data regulations, due to the sensitivity of such information.

	This will provide the team the opportunity to do their spot checks on the accuracy of the data and ensure that the support is readily available when requested. Management should identify how information can be provided from Capita in a more timely basis and investigate if there are or have been breaches of Service Level Agreements.	
Goods Received Not Invoiced	In our testing of creditors we have identified old GRNI within the year-end balances, some of which date back as far as 2017. The likelihood of these items being invoiced diminishes over time, and although the GRNI report is generated by the system, services are expected to review the items relating to their area. These should be reviewed on an annual basis with any older than 12 months being justified for continued inclusion. This could potentially free up committed expenditure from budgets.	Work was undertaken prior to 31st March 2023 to remove many of the smaller receipts without an invoice, which were older than twelve months. A project group has since undertaken a detailed analysis of all receipts without an invoice allowing each accounting team to liaise with their service to review any outstanding GRNIs. Where they are no longer needed then the system is forced to complete the transaction. Regular monthly monitoring has now been integrated into business as usual and services have seen a benefit to their revenue position.
Internal transfers of income (recharges)	As set out in Section 4 of this report, we have identified items of income in relation to schools, has been doublecounted both in the records of the Council and on consolidation of the Schools' balances. This clearly	The Accounting and Schools teams have built in a joint manual review process at year-end to ensure income is not reported in both schools and the consolidated Council balances. It is confirmed that

	leads to an artificial grossing-up of both the income and expenditure figures in the CIES. Management have not amended these balances as there is no net impact on the Surplus/Deficit on the Provision of Services. Management should ensure that processes are in place to manually review for double-counted income, in particular in relation to schools and perform, where applicable, manual adjustments to remove the additional entries from the financial statements.	for the 2022/23 accounts the Schools team ensured items of income identified by EY were part of the manual adjustment and not double counted.
Disbursements to third parties.	In our testing of other contributions, we identified a receipt of income (£1m) that was in relation to the repayment of short-term liquidity support provided to an NHS organisation. NHS organisations are prohibited from obtaining financing from external sources. We have investigated the circumstances of this payment; management within the Council and the third party have set out the details of the transaction and we have concluded that the transaction is lawful from the Council's perspective. However, the way the matter was transacted could have been clearer and better documented. Where unusual transactions are made, management should document the governance processes followed and consider whether there is any potential reputational risk to the Authority by making payments alongside the usual considerations made in	The Council provided short term assistance to our NHS Partners in the city in 2021/22. Who were operating in an emergency Command and Control role during Covid. We acknowledged at the time that our internal processes should have been better and would improve and ensure the necessary governance processes are better documented, should such a scenario occur again.

	relation to liquidity and income generation.	
Highways Infrastructure Assets	As noted in Section 02, management should consider how they can identify a meaningful basis upon which the balance of Highways Infrastructure capitalised through the PFI contract can be apportioned to each of the categories of:- Streetlighting; Carriageways; and Footways.	The Accounting team is working with Amey and our Contracts team to understand the new potential accounting requirements and how historic and future data, and balances, may need to be categorised and accounted for. For information the Council applied the Statutory Instrument in relation to infrastructure assets in 2021/22, which is subject to future guidance to be issued by CIPFA.
Highways Infrastructure Assets	As noted in Section 02, currently, due to the age profile of the majority of the Council's Highways Infrastructure assets, there has not yet been significant replacement of the Assets acquired under the PFI Contract. As the contract matures, it will be necessary for the Council to introduce a mechanism for monitoring where assets are replaced and establish an accounting policy for how to ensure the Financial Statements and Fixed Asset Register remain materially correct.	Amey provides the Council with asset information to a good standard. The Accounting team is working with Amey and our Contracts team to see how this information, together with other contract monitoring mechanisms, can be utilised to account for asset replacement. For information the Council applied the Statutory Instrument in relation to infrastructure assets in 2021/22, which is subject to future guidance to be issued by CIPFA.
Highways Infrastructure Assets	Currently the Council depreciate all assets acquired under the Highways PFI contract over a period of 40 years, regardless whether the Asset is a footway,	The Accounting team is working with Amey and our Contracts team to understand how the data held in the asset register can be utilised to report

	carriageway or streetlight. This is believed to be in line with the PFI contract providing for the assets to be maintained to this level of economic life. Further to our recommendation earlier in this report, once a basis has been established to apportion the costs capitalised under this contract, consideration should be given to CIPFA guidance that suggests that carriageways and footways would be subject to lower useful economic lives.	on asset lives for accounting purposes. For information the Council applied the Statutory Instrument in relation to infrastructure assets in 2021/22, which is subject to future guidance to be issued by CIPFA.
Leases – Council as Lessor	Although the projected error was below our reporting threshold, we identified a lease where the Council hadn't billed for ground rent for over 5 years. Management should review other similar lease arrangements and cross-reference to billing records for any omissions.	Following the audit finding, an invoice for the 2021/22 ground rent has been raised for the lease identified by EY and will continue to be billed for its remaining lease term. Property Services are reviewing similar lease arrangements and if found to have any billing omissions these are being corrected. Preparing for the implementation of IFRS 16 is highlighting the importance of maintaining comprehensive leasing information.
Highways Infrastructure Assets	For our testing of Infrastructure Assets held that have not been acquired under the core PFI contract, the council has an approved business case to support the underlying assets. For a portion of a sample of these assets, the Business Cases were not detailed	The Accounting team is working with Amey, our Contracts team and our Capital & Construction team to understand the new potential accounting requirements and how historic and future assets contained within the Infrastructure fixed asset

	sufficiently for us to be able to identify the specific asset and gain assurance over its existence. Due to the implementation of the Statutory Instrument we are comfortable that the balances remain stated fairly and in line with the appropriate financial framework. We recommend that the council note these exceptions and consider how they will seek to ensure that following the end of the temporary relief offered by the SI, assets contained within the Infrastructure FAR are supportable.	register are evidenced and supported. For information the Council applied the Statutory Instrument in relation to infrastructure assets in 2021/22, which is subject to future guidance to be issued by CIPFA.
Schools Bank reconciliations	Supporting evidence provided in respect of bank reconciliations for schools was in editable format and did not always demonstrate review had been appropriately performed. Management should ensure a process is introduced that formalises evidence of approval, in a timely nature, of, at a minimum, the year-end bank reconciliations performed at schools.	As this was a late recommendation and was not raised until September 2023, it was not feasible for the Schools finance team to implement in 2022/23. Therefore, the Schools finance team are looking to see where improvements can be made in the process of providing year end, as a minimum, bank reconciliations for 2023/24 and have requested further clarification from EY to allow them to progress.