Ipswich Borough Council

External Audit Update Report

December 2016

Ernst & Young LLP
Audit Committee
Ipswich Borough Council
Grafton House
15-17 Russell Road
Ipswich
IP1 2DE

02 December 2016

Dear Members

External Audit Update

We are pleased to attach our Audit Update Report.

This report summarises the work we have undertaken to date and our plans for the remainder of the 2015/16 audit.

We welcome the opportunity to discuss this report with you as well as understand whether there are other matters which you consider may influence our audits.

Yours faithfully

Kevin Suter
Ernst & Young LLP
United Kingdom

Enc.
Contents

1. Summary ................................................................................................................................................. 1
2. Financial statements issues identified ................................................................................................. 2
   2.1 Prior year audit adjustments identified to-date .............................................................................. 2
   2.2 Other issues ....................................................................................................................................... 4
3. Areas for completion ............................................................................................................................. 5
4. Audit Fees ................................................................................................................................................ 6
5. Looking forward ....................................................................................................................................... 7
1. Summary

The purpose of this report is to provide the Audit Committee with an overview of the stage we have reached in planning and performing your 2015/16 audit.

Our previous interim Audit Results Report presented to the Audit Committee on 30 August 2016 was written at a very early stage of the audit due to the Committee deadline. Since the writing of this report, a significant number of errors and technical matters have been found and are detailed for the Audit Committee's attention below.

During October and November the audit team has worked on the Council’s housing benefit certification in order that no cashflow penalties should arise from late certification of the claim. The team have recommenced the audit work in December with the aim of completing the audit on site work by the end of December.

Due to the volume of adjustments the revised final financial statements and our final Audit Results Report will need to be reviewed by all Members following the conclusion of our audit work. We recommend that Members have a number of days to review the amendments and the final report before the delegated arrangements to approve the final accounts are exercised.
2. Financial statements issues identified

2.1 Prior year audit adjustments identified to-date

A significant number of issues were identified from our audit testing undertaken to date. So far this has resulted in the following prior year adjustments (PYA) being required.

Verification of all the values quoted below will only be obtained following detailed testing of the current and prior year balances (including a third balance sheet where required) by our audit work in December.

2.1.1 PYA1 – Accumulated depreciation

Property, Plant and Equipment cost/valuation and accumulated depreciation were both inflated by a total of £155.781m. The Council’s accounting policy is to write off the accumulated depreciation and impairment when revaluations occur however we have been advised by the Finance team that this has not previously been actioned.

2.1.2 PYA2 – Assets Held For Sale

The in-year disposals of £3.676m on PPE and £0.161m on Investment Properties had been incorrectly treated as Assets Held for Sale.

The adjustment goes back to financial year 2010/11 when the accounting treatment for Assets Held for Sale was first introduced in the Local Government accounts.

2.1.3 PYA3 – Impairment loss

Impairment losses due to a reduction of cost to existing use value (social housing) on newly built Council Dwellings had been incorrectly classified as Revaluation Losses Recognised on the Provision of Services, totalling £5.545m.

We understand that the issue goes back to the financial year 2008/09 when the property market was affected by the financial crisis in 2008.

2.1.4 PYA4 – Enhancement on HRA

Enhancement incurred on Housing Revenue Account assets had been treated as impairment loss charged to the Surplus/Deficit on Provision of Services and reversed out to Capital Adjustments Account. No reversal of the impairment had been done when these assets were revalued upward in subsequent years. Instead, the gain had been credited to Revaluation Reserves. As a result, Revaluation Reserves were overstated and Capital Adjustments Account was understated.

The 2015/16 enhancement expenditure was £7.4m while the total between 2008/09 and 2014/15 was £67m. In addition, the difference between fair value depreciation and historical cost depreciation is currently shown as £1.215m in Note 13.1 in the accounts (2014/15 was £1.509m). As the Council only started to book in Revaluations Gains of £5m on Council Dwellings in 2013/14 which went up to £26m in 2014/15, with a useful life of 60 years on all assets, it is thought the misstated amount relating to depreciation is unlikely to be material.

RAM (the fixed assets system) currently shows an opening balance of an ‘Impairment Reserve’ of £142m (and a closing balance of £153m).

Of the total,

a. £67m relates to enhancement spent on Council Dwellings which had not been allocated to the individual assets nor by Beacon group as described above.
b. £4m relates to a form of classification used by the Council for additions to assets (known as ‘child assets’ and ‘parents assets’ and hence these movements are not real impairments and require amendment;

c. £20m relates to Investment Properties which do not have impairment losses and therefore do not represent actual impairments.

The remaining £52m is ‘genuine impairment’ resulting from the valuation exercise that should have been classified as Impairment Loss rather than Revaluation Loss which had been charged to Surplus/Deficit on Provision for Services.

2.1.5 PYA5 – Group accounts opening balance

Income tax and charge for actuarial (gains)/losses attributable to Ipswich Buses Ltd had been incorrectly classified as unusable reserves in the group accounts. As a result the opening balance of Usable Reserves is overstated by £3.536m while the Unusable Reserve is understated. It is our understanding that the issue has existed since the consolidation of group accounts was implemented.

2.1.6 PYA6 – Heritage Assets

The total museum collection is insured for £100m; however the Council only recognised £60.1m in the accounts for objects that have specific valuations and disregarded the remaining items due to the lack of specific valuations for these items. Paragraph 4.10.2.9 of the Code specifies that valuation may be made by any method that is appropriate and relevant, and this may include, for example, insurance valuations of museum collections.

We would therefore expect the whole amount of £100m should be recognised as Heritage Assets. Hence the Heritage Assets are understated by £39.9m as is the Revaluation Reserve. We have been made aware that the issue goes back at least to the financial year 2013/14.

2.1.7 PYA7 – IAS19 split between General Fund and HRA

The Council split the IAS19 costs between the general fund and HRA (on a ratio of 0.83 : 0.17 based on actual costs) at the Cost of Services level in CIES. However it had omitted the split on the following:

► Net Interest on the Defined Benefit Liability, £3.030m (2014/15 was £3.193m) and

► Re-measurement of the Net Defined Liability, -£28.345m (2014/15 was £17.543m)

Hence there is a lack of consistency in the approach which failed to meet the Code requirement.

Based on the ratio as above, the (Surplus)/Deficit for the Year on HRA Services in the HRA Income and Expenditure Statement is understated by a total of -£4.303m as follows:

► Net Interest on the Defined Benefit Liability, £0.515m

► Re-measurement of the Net Defined Liability, -£4.818m

In addition, it is noted that there is an understatement of £60k in the HRA due to the incorrect calculation of back-funding.

We are awaiting officer confirmation if this issue affects prior years.
2.2 Other issues

2.2.1 Capital Grants Unapplied Account

A total capital grants and contributions of £5.008m was received in 2015/16 but the total amount reversed out via Adjustments between Accounting Basis and Funding Basis was only £4.244m, hence a potential misstatement of £0.764m was incorrectly credited in CIES to fund revenue expenditure.

We understand that the £0.764m relates to Section 106 income received in the prior year which is now believed to have been credited to the Capital Grants Unapplied Account (CGUA). In 2015/16 that amount has been shown as revenue expenditure due to the client not assessing whether Section 106 money is for capital or revenue purposes.

Officers are to investigate whether this was the case and also to provide us with a breakdown of income that made up the CGUA balance of £1.377m in the balance sheet. This will enable the actual amount by which the CGUA is overstated to be identified and corrective action taken based on the level of the error.

2.2.2 Pension arrangement with Ipswich Buses Ltd

Ipswich Buses closed their local government scheme in 2010 and agreed to pay the Council a sum (circa £0.14m) each year until 2035. The scheme only has pensioners and deferred members.

As confirmed by Suffolk Pension Fund, Hymans had previously produced two IAS19 reports despite the fact that the Council and Ipswich Buses operate one fund with one employer, and the Council are liable for any deficit incurred by Ipswich Buses.

The nature of the arrangement appears to meet the definition of a Defined Contribution Scheme rather than a defined benefit scheme as set out in paragraph 6.1.2.1 of the CIPFA Accounting Code and we are carrying out detailed audit work to review this area and determine the nature of adjustments required.
3. Areas for completion

The following areas are still to be completed by our audit work in December.

► Property, plant and equipment – resolution of valuation/impairment issues relating to assets and review of the RAM system to determine correct usage required before detailed testing can be progressed.

► Group accounts – Require the details of the pension guarantee given to Ipswich Buses and whether a provision is required in the Council’s accounts.

► Correction of the points raised in EY’s technical review – review of detailed working papers to support all changes made to the revised statement of accounts for these issues, including the impact on all primary statements and notes to the accounts.

► Completion of our detailed review and conclusion procedures.
4. Audit Fees

The volume of errors found to date is significantly in excess of our planning expectations, that were set out in our Audit Plan presented to the March 2016 Committee. The financial statements presented for audit required extensive amendments in order to be compliant with the CIPFA Code of Accounting Practice.

Our current estimate of additional fees needed to address the areas identified above is in the region of £45,000 - £50,000. This incorporates the following estimates:

- Additional time needed for completion of the group accounts work, including liaison with and review of the work of the auditor of Ipswich Buses, KPMG - £5,000
- Additional work on the accounts, including work to review and address the errors noted above, including the work of a technical expert from EY’s financial accounting and advisory services – estimate of £37,000-£42,000
- Additional time needed for work on the additional VFM significant risk relating to the set-up of the new company, Ipswich Borough Assets - £3,000
5. Looking forward

Despite the difficulties experienced in the completion of the 2015/16 audit, we are still looking ahead with the Council’s officers to the forthcoming shortening timescales for the production and audit of the financial statements. For 2017/18 the timetable moves from the current deadlines of 30 June and 30 September for the production and audit of the statements respectively, to 31 May and 31 July.

Given this timetable it is important that all the issues identified in 2015/16 are fully resolved, to establish a clear base for future years.

We have held initial meetings with officers to explore opportunities to meet this timetable, sharing knowledge from our experience at other clients and discussing initial plans where audit testing can be undertaken earlier in the year.

During the course of the 2015/16 audit we have identified a number of opportunities where working papers could be improved to assist the efficiency of our audit, including better provision the sources of evidence needed for audit. We have also identified opportunities where the Council could reduce some of the documents that it produces.