

Progress report of the audit of the 2017-18 Financial Statements for Warwick District Council

Year ended 31 March 2018

September 2018

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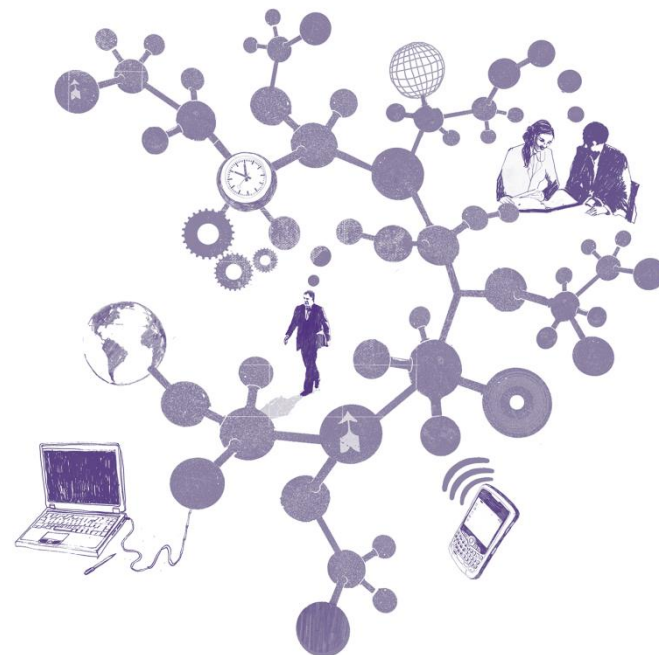
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25th September 2018

Dear Members

Progress report of the audit of the Financial Statements for Warwick District Council for the year ending 31 March 2018

This progress report presents the findings to date arising from our audit of the District Council's accounts for the year ended 31 March 2018. We were due to have concluded our audit in time to present our full Audit Findings Report to the 25 September meeting of the Finance and Audit Scrutiny Committee, but for the reasons set out in this report, this has not been possible. This report is being presented in order to inform you as 'Those Charged with Governance' of the progress on the audit, the key findings so far and the reasons for the further delay.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland) ('ISA (UK&I)'), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements and giving a value for money conclusion. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Yours sincerely

Grant Patterson
Engagement Lead

Chartered Accountants

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Executive Summary

This progress report presents the findings to date arising from our audit of the District Council's accounts for the year ended 31 March 2018.

As we reported in July we had established a revised timetable with the Council with the aim of concluding our audit in time to present our full Audit Findings Report to the 25 September meeting of the Finance and Audit Scrutiny Committee but, for the reasons set out in this report, this has not been possible.

There are two key reasons why the conclusion of the financial statement audit has slipped from the revised timetable:

The first, is the large volume of remedial work that was required by the finance team in order to produce a revised set of accounts. It is clear that almost all of the capital transactions included within the published set of financial statements were incorrect, and these have had to be unpicked, and then the work completed again.

Secondly, in addition to the volume of work, the finance team have also suffered significantly reduced capacity during this period. The Council has been successful in obtaining, in the short-term, the services and support of staff that had produced the accounts in previous years which has enabled progress to be made on items identified to the Committee in July and the revised set of accounts to be produced. However, key members of the finance team have either been on leave, following an agreed part time working pattern, or off sick which has meant progress on quality assurance and the preparation of working papers (with high quality supporting evidence 'right first time') is behind that expected resulting in additional audit queries and work.

The reduced capacity within the finance team continues to be a significant concern. Discussions with the Head of Finance confirm that during the final week of September there will only be one suitably qualified member of staff in the team, and it is unlikely that they will have sufficient knowledge or capacity to clear the remaining audit queries and process the adjustments needed to the accounts.

We continue to have constructive discussions with senior officers as to an appropriate revised timeline for the completion of the audit of the 2017-18 financial statements. The key challenges that need to be addressed at this time are:

- ensuring that the audit team has access to suitably qualified finance staff that can address issues in a timely manner, and
- the ability of the Council to provide the remaining working papers required and respond to all queries raised.

We will continue to work with officers to reach a conclusion on the audit, however this will be dependant on the resources and capacity that the Council has available to resolve the issues identified.

Looking further forward we are aware that the Chief Executive is undertaking a review of how this year's position has arisen and actions the Council needs to take to ensure it is not repeated.

Grant Patterson

24 September 2018

Purpose and background

Purpose of this report

This progress report presents the findings to date arising from our audit of the District Council's accounts for the year ended 31 March 2018. As we reported in July we had established a revised timetable with the Council with the aim of concluding our audit in time to present our full Audit Findings Report to the 25 September meeting of the Finance and Audit Scrutiny Committee but, for the reasons set out in this report, this has not been possible.

This report is being presented in order to inform you as 'Those Charged with Governance' of the progress on the audit, the key findings so far and the reasons for the further delay. We have focused specifically on the issues that need to be addressed to ensure that the 2017-18 accounts can be finalised and an audit opinion issued. We will include specific commentary and recommendations on the accounts productions process as part of our final Audit Findings Report.

We continue to have constructive discussions with senior officers as to an appropriate revised timeline for the completion of the audit of the 2017-18 financial statements. The key challenges that need to be addressed at this time are:

- ensuring that the audit team has access to suitably qualified finance staff that can address issues in a timely manner, and
- the ability of the Council to provide the remaining working papers required and respond to all queries raised.

This report intentionally does not cover all of our duties and responsibilities, and nor does it therefore meet all of the areas we are required to report to you under *International Auditing Standard 260 – Communicating with Those Charged with Governance*. Our subsequent report will address all the required areas.

Background

We reported to members in July that there had been a number of significant issues with the draft accounts and production process that had resulted in the finance team being unable to produce a set of accounts with a balanced Movement in Reserves Statement (MiRS) or associated supporting note (Note 8).

As a result of remedial work undertaken by the finance team to balance the MiRS, the Strategic Finance Manager highlighted to the audit team on the 6 July that the volume of work needed to correct the issues identified within the capital and capital financing elements of the accounts was too significant for them to be completed by the end of July. As a result it was acknowledged that the Council would miss the statutory deadline of the end of July and instead commit to finalise the accounts and provide the necessary working papers and assistance to the audit team in order for the opinion to be given by the end of September.

In order to meet this revised timeline we initially agreed with officers that a revised set of accounts would be available on the 10 August, ready for the audit visit to commence on the 13 August. Officers agreed that these accounts would be formally signed off by the s151 officer to demonstrate that all of the statements balanced and that, in their view, they were fully compliant with the CIPFA Code.

In line with the agreed timescale the audit team returned to the audit on the 13 August to commence the audit, however a revised set of statements and working papers were not available. We met with the Deputy Chief Executive and members of the finance team on the 13 August, and discussed the progress made to date by the finance team. Due to various holiday commitments, some unforeseen staff absences plus further issues identified, the finance team had not been able to make progress in line with their expectations.

A revised timeline of the 5 September was then agreed as the latest possible date a set of statements could be presented for audit in order to seek to have audit work concluded by 25 September. At this time it was acknowledged that while the audit team could put in additional resources for that shortened audit 'window', achievement of the end of September would only be possible if no new significant issues were encountered, the accounts had been subject to a full quality check prior to submission for audit and were supported by appropriate working papers. Ensuring the availability of appropriate finance staff to provide timely answers to queries raised by the audit team would also be critical.

The Accounts Audit

Progress made since the previous report

Our report in July highlighted the key areas where the finance team needed to focus their effort. The table on the following pages repeats the key areas identified and the progress that has been made in the intervening period.

Key issues of focus for the finance team	Commentary on progress
The MiRS and it's associated notes do not correctly balance. In an attempt to balance the MiRS officers identified significant issues with year-end journal transactions associated with capital financing. As a result, a whole scale review of the capital transactions was underway to ensure that these could be corrected for version two of the draft financial statements.	The statements presented for audit on the 5 September included a balanced MiRS statement and associated note. The finance team had completed it's full review of the capital financing transactions and made the correcting journals in order to produce a revised set of financial statements.
In undertaking a high level review of the accounts, the audit team identified that the Council had continued to use the Major Repair Allowance (MRA) as a proxy for calculating depreciation on it's housing assets. A change in the Code for this current financial year has meant that this is no longer acceptable, with authorities required to calculate depreciation on an appropriate basis, including the consideration of componentisation. Some work has been undertaken on this area by the finance team, and this has identified that a material change to the draft accounts is needed to ensure compliance with the Code. The finance team have included the work necessary on this in their revised timeline.	The statements presented for audit on the 5 September have been prepared using the appropriate basis for the calculation of depreciation on housing assets.
Officers raised concerns over the inability for the finance team to balance the bank reconciliation at year end. They highlighted to us an imbalance of £250k that they were currently unable to explain. While this is not material, it could indicate a fundamental issue with the balances of the Council, and this is a key area that will need to be resolved prior to the revised financial statement being produced.	<p>We have now completed our work on the cash balances and can confirm that officers have been able to bring the bank reconciliation in line with expectations. There remains a trivial reconciling item. Officers were able to complete this work with the assistance of the formally retired capital accountant who had the necessary understanding of the system in place.</p> <p>Our view remains that the system and process for reconciling the bank remains overly complicated and without the assistance of the former officer the Council would not have had the necessary expertise to be able to resolve the issue. This is a key issue for the finance team going forward, and it is essential that the skills and knowledge of this former employee are captured prior to him recommencing his retirement.</p>

The Accounts Audit - Progress made since the previous report (continued)

Key issues of focus for the finance team

Audit Evidence - following our initial week on site, we left officers with a detailed list of working papers and supporting evidence that needed to be provided ready for the audit team on the 13 August. We discussed with the team the level of evidence required and the issues that need to be addressed. We reminded officers that a screen print of the ledger is not sufficient and appropriate evidence to support a transaction within the accounts.

We also highlighted the need for other members of the finance team to understand the working papers that had been produced by members of staff that were no longer with the Council. There were key areas of the financial statements that had been produced by staff that had left, and arrangements needed to be in place for other members of the finance team to explain the entries that have been made and answer audit queries in an efficient and effective manner.

We agreed with officers that a revised set of accounts would be available on the 10 August, ready for the audit visit to commence on the 13 August. These accounts would be formally signed off by the s151 officer to demonstrate that all of the statements balanced and that, in his view, they are fully compliant with the Code.

Commentary on progress

While some progress has been made in this area, the availability and quality of working papers has continued to be a significant barrier for the audit team to be able to complete the work required. As noted revised accounts, and therefore all working papers, were not available for the 13 August.

Whilst progress had been made on working papers for our return on 5 September a number were still outstanding. There remain key working papers that officers need to complete to demonstrate where they have applied judgement or reached certain conclusions.

In many instances the supporting documentation to support the transactions remains a screen print of the ledger. At the suggestion of the Head of Finance we held a meeting with all members of the finance team and stressed the importance of the role they had to play in providing appropriate evidence. We highlighted the type of evidence that was required along with the need to provide a few sentences of narrative explanation to the auditor to highlight what source documentation had been provided and why it supported the transaction in the accounts. Whilst there have been some improvements this has not been applied consistently to the information we have received resulting in follow up queries and further delays.

The Head of Finance has been successful in managing to gain the services of the formerly retired capital and revenue accountants. As such the finance team have had access to their knowledge and expertise, which has greatly assisted in being able to produce the revised set of financial statements.

These officers have also been able to explain key working papers and produce additional working papers that were originally missing when the accounts were first produced. As noted above it is essential that the knowledge and expertise of these individuals is captured to enable the finance team to be able to move forward and ensure that it has the information needed in future years.

As previously highlighted officers were unable to meet the 10 August deadline, instead providing the accounts for the 5 September. The accounts provided on the 5 September were signed by the Head of Finance, and the audit team were informed that they were complete and accurate with one exception. The exception was in relation to the valuation of a leisure centre which was outstanding from the valuer. The Head of Finance informed the audit team that this would likely result in a further material adjustment to the accounts. Given this was the only known adjustment the audit team accepted the accounts and commenced the necessary audit work.

The Accounts Audit

New issues identified from the work completed to date

From the work completed to date following receipt of the updated accounts on 5 September, we have identified the following matters:

Key issues identified	Next steps
<p>The accounts presented for audit on the 5 September do not show evidence of having been subject to a formal quality check. An initial read through by the audit team for consistency and additions highlighted a significant number of errors; in particular:</p> <ul style="list-style-type: none">• Narrative Report - while the tables in the narrative statement had been updated, the narrative around the table had not, resulting in various inconsistencies which would make it difficult for a reader of the accounts to understand• Notes to the Accounts - both the Comprehensive Income and Expenditure Statement and Balance Sheet have been amended, however, this had not ‘flowed through’ to the supporting notes to the financial statements. This has resulted in inconsistencies in the accounts, and in a number of cases different amounts quoted in the accounts for key balances such as debtors and creditors.• Group Accounts - The revised group accounts presented, did not balance, as inappropriate signage of whether an entry was a debit or a credit had been used for a key item, plus additional columns had been presented that were not required.	<p>The finance team have been given a full list of the inconsistencies identified and are working to resolve these issues. Officers have been reminded of the need to undertake a full quality check of the accounts once all of the amendments have been processed.</p>
<p>The revised accounts provided to the audit team on the 5 September demonstrated material movements on the group accounts. Our understanding from officers has been that the group arrangement with PSP has been assessed as a joint venture and as such in line with the Code we would expect that this is consolidated in on an equity method. The revised accounts appear to show that the accounts have been consolidated in on a line by line basis as if the company were a subsidiary.</p>	<p>We have discussed this with officers who are reviewing their treatment. The audit team are consulting with technical colleagues to confirm that this would need to be treated as a departure from the Code.</p>
<p>In order for the finance team to produce the revised set of financial statements they have had to produce a significant number of journals to correct the issues identified and ensure that the ledger accurately reflects the financial position of the Council. To date, while these journals have been processed, there remain some where further supporting documentation needs to be provided to audit.</p>	<p>Members of the finance team are aware that additional supporting information is required for the journals to enable the audit team to complete the work required.</p>
<p>There remain key areas of the accounts where work remains ongoing, for example Grants and other contributions, operating expenditure, provisions and Housing Benefit expenditure.</p>	<p>We continue to work with finance staff to progress the outstanding queries. It remains essential that finance staff respond to these queries promptly and with the required level of detail to ensure the audit can be completed.</p>

The Accounts Audit - New issues identified from the work completed to date (continued)

Key issues identified	Next steps
<p>The following issues raised as part of our review of the draft accounts produced in May remain unaddressed;</p> <ul style="list-style-type: none">As part of our planning and interim work we were informed that the purchase of the £6m of equity investments were needed to be classified as level 2 investments. The draft financial statements produced have classified this investment as a level 1. We have asked officers for an explanation as to the change in classification and the supporting evidence.Can you confirm the nature of the arrangement with Nuneaton Borough Council in relation to HEART and whether this will require any additional disclosure in the financial statements.Within the narrative statement you have stated that the Covent Garden car park is beyond economic repair. How has this impacted on your consideration of the valuation recorded in the financial statements and has this resulted in an impairment?	<ul style="list-style-type: none">Officers have provided some initial evidence that suggests that the investments should be classified as level 2 investments. As a result, changes will be needed to the financial instruments disclosure, in particular this is likely to result in the need to make further enhanced disclosures.This has been discussed with officers and we understand that further work is ongoing in this area. As a minimum we have suggested to officers that additional disclosures will be needed in relation to related party transactions.We have discussed this issue with officers and understand that the asset has not been impaired as the valuation has been based on the service potential of the asset. We have asked officers to provide a working paper to demonstrate how they have considered the triggers of impairment, and why they consider it not appropriate to apply them in this instance.
<p>Our testing of PPE additions has identified two potential errors. In one instance we have identified expenditure of £600k where officers are currently unable to provide any supporting documentation. The other error relates to £500k which appears to have been accounted for in the incorrect period.</p>	<p>We are working with officers to resolve these issues, however given the nature of the errors it will be necessary to further extend our sampling in this area to ensure that there is not a material error in the accounts.</p>
<p>The revised valuation of the leisure centre has been received. The impact of the adjustment is to increase the net book value by £5.3m with consequential movements within figures currently held as work in progress/assets under construction.</p>	<p>The required amendments will need to be processed and audited in the final set of financial statements.</p>
<p>Our testing of the creditors population has been delayed as finance staff have experienced difficulties in obtaining a breakdown of the population.</p>	<p>We understand that it took officers a day to produce the transaction listing to provide to audit. The audit team have now picked a sample and are awaiting the appropriate supporting evidence to conclude this work.</p>

The VFM conclusion

In addition to the opinion on the accounts, we are also required to issue a conclusion on your VFM arrangements. The guidance identifies one single criterion for auditors to evaluate as follows;

“In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.”

This is supported by the three sub-criteria of informed decision making, working with partners and other third parties, and sustainable resource deployment.

A key element of informed decision making is the ability for the Council to accurately report its financial position to members in a timely manner. From the information we have reviewed to date, the outturn position that has been reported to members is not materially different from the final position, however this could be subject to change if additional errors are identified on the financial statements.

While we do not consider the information that has been presented to members for their decision making to be materially inaccurate, the timeliness of this reporting, and the ability of the Council to produce financial statements in line with the statutory deadline does require us to re-consider the risks to the VFM conclusion.

In line with the firm's procedures we are currently consulting on the impact of the delay to the financial statements to the VFM conclusion. It is possible that this will result in an 'except for' qualification to the conclusion.

The Way Forward

There are two key reasons why the conclusion of the financial statement audit has slipped. The first, is the large volume of remedial work that was required by the finance team in order to produce a revised set of accounts. It is clear that almost all of the capital transactions included within the published set of financial statements were incorrect, and these have had to be unpicked, and then the work completed again.

In addition to the volume of work, the finance team have also suffered a significantly reduced capacity during this period, with key members of the team either being on leave, following an agreed part time working pattern, or being off sick.

The reduced capacity within the finance team continues to be a concern, and discussions with the Head of Finance confirm that during the final week of September there is only one suitably qualified member of staff in the team, and it is unlikely that they will have sufficient knowledge or capacity to clear the remaining queries and process the adjustments needed to the accounts.

We will continue to work with officers to reach a conclusion on the audit, however this will be dependant on the resources and capacity that the Council has available to resolve the issues identified.

Looking further forward we are aware that the Chief Executive is undertaking a review of how this year's position has arisen and actions the Council needs to take to ensure it is not repeated.



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