Agenda Item 7

Audit & Accounts Committee Update

Date: 18/11/2015
From: Clive Everest (External Audit Partner)
To: Audit and Accounts Committee, Cambridgeshire County Council
Subject: Audit Update, Including additional work on Assets Under Construction (AUC)

The purpose of this paper is to update the Audit and Accounts Committee on the progress of the audit of the 2014/15 accounts of the Council, and of the Pension Fund.

We presented our draft ISA260 to the Committee on 22 September 2015 setting out our draft findings and progress as at that time. This paper should therefore be read alongside that document. Our formal report on the audit will be contained within our final ISA260 document which will be issued to the Committee when we have finished our audit work.

Audit progress

With the exception of the work below in relation to AUC, we are pleased to report that we have completed our audit fieldwork on both the Council and Pension Fund audits, and no further matters have arisen which we need to report to the Committee.

Once work is complete on the AUC Prior Period Adjustment and related disclosures we will therefore be able to sign the accounts.

Assets Under Construction

Background

At the previous audit committee we reported to the Committee that work was still ongoing in relation to the audit of the closing Assets Under Construction (AUC) balance in the Council's Balance Sheet.

Given that this amount should all relate to current projects, we had asked management to provide a listing of on-going projects to support the figure in the Council's draft accounts. The listing provided showed that the value of these projects was significantly lower than the value disclosed in the AUC category in the draft accounts.

Management therefore investigated this matter and produced a paper in response to our finding, which was tabled at the September 2015 Audit and Accounts Committee.

This was the first time that we saw this high level analysis, which showed that management anticipated a material adjustment was needed to reduce the balance, which appeared likely to require a Prior Period Adjustment.

Update since the September Committee

Following on from the audit committee in September, PwC have been working with the Council to resolve this issue. In this time we acknowledge that the Council have spent a large amount of time and effort to analyse this balance further, including analysing accounting records going back over a number of years.

While management were working through the analysis, we have worked with them to discuss the process they were undertaking and give guidance as needed. We were provided with the initially approved working paper on 08/10/15, but did not receive the approved double entries relating to the error until 26/10/15. These working papers were not finalised by management until 16/11/15. The time taken for management to undertake this review reflects the depth of analysis needed to be undertaken and the complexity of the process in some cases. Without management's investment of time to focus on this issue this could have caused considerably longer delays in the accounts timetable.

Since receiving these documents, we have been working with management to gain supporting evidence for the adjustments that they are proposing to post within the final accounts. Because of the complexity and scale of the adjustments proposed we are testing over 60 projects and items of expenditure to gain the necessary audit assurance, which is in turn a time consuming process. We are making progress, but as at the date of this document this work is still on-going and we will give an oral update at the Committee on the status of this at that time.

On completion of our testing, we will need to fulfil our internal review procedures and re-consult our technical team. At the time of writing this update, we are pleased to say that we have not noted any significant findings on the proposed adjustment.

Considerations on qualification of the accounts

Further to the initial report presented by management at the last Audit and Accounts Committee, management believe that they have identified to a material extent all of the underlying transactions making up the figure of AUC in the 2014/15 draft accounts of £189m.

If our testing identifies no material, and the proposed adjustments are properly made to the accounts and disclosed, then we would hope to be in a position to issue an unqualified opinion on the accounts. We will however need to formally review this at the conclusion of our work.

Details of proposed adjustment to AUC

Management's proposed adjustment is to reduce the AUC balance on the balance sheet by £153m, to £36m.

The analysis provided by management shows that a significant proportion of the value previously shown in the AUC category should not be presented there in the accounts, and that the majority of this balance represents an error that should be corrected by means of a Prior Period Adjustment. Detail of the proposed adjustment is shown in the new note to the accounts and also in the table below.

To summarise, the adjustments below reduce the AUC balance in the draft accounts and move the balances to the respective sections of the balance sheet or reserves. The nature of the error relates to the technical accounting for the recognition of assets, and no evidence has been identified to suggest there is any material physical loss or failure to safeguard the Council's assets.

As the draft AUC balance comprised of over 1,000 individual projects, the adjustment to correct the accounting entry will vary dependent on the project. The correcting entry depends, for example, on the nature of spend, if the asset has an existing revaluation reserve or if should be just sitting in another asset category. The table groups similar projects together and then shows the cumulative adjustment to that category.

Transfers to:	Amount £'000	Notes
Land and Buildings (L&B)	-4,280	Relating to finished construction projects which were not transferred out of AUC and into Land and Buildings. This adjustment is therefore just a transfer between PPE categories with no impact on Net Assets.
Reserves (Capital Adjustment account ["CAA"])	-71,640	This balance is split into 3 elements: (a) £6,874k relates to projects which were correctly initially recorded within AUC, but were not transferred out on completion, and which have since been disposed of or demolished. The loss on disposal should have been recognised initially in the CIES, but then moved to the Capital Adjustment account in line with the treatment required by the Local Government Code of Practice. (b) £48,953k relates to buildings projects which were initially correctly recorded within AUC and should have been transferred to Land and Buildings on completion. In all instances, adjustment to the CAA is appropriate since the adjustment could not be wholly offset against the revaluation reserve of a particular asset. All of these buildings have since been revalued as part of the Council's PPE revaluation programme, meaning the assets have been double-counted in the accounts since the revaluations were conducted. (c) £15,813k relates to the correction of errors in the accounting of the transfer of

		assets from AUC to completed assets in prior years.
Reserves (Revaluation Reserve)	-33,863	This balance also resulted in assets which have been double counted in both AUC and Land and Buildings, however, these assets all have a revaluation reserve attached to them. In all cases, the assets have been revalued since being capitalised, and in the majority of cases the capital works were represented by extensions to existing assets. The adjustment has therefore been offset against the revaluation reserve, as the revaluation uplift initially recognised would have been too high. Where these assets had a revaluation reserve, but this is not sufficient to offset the entirety of the required adjustment, the balance has been adjusted to the CAA, and is accordingly represented in the £71,640k above.
Infrastructure	10,699	This relates to three erroneous transfers from AUC to Infrastructure in prior years. Therefore the value needs transferring back to AUC. This adjustment is therefore just a transfer between PPE categories with no impact on Net Assets.
Revenue	-11,345	Expenditure on numerous items that should not have been capitalised by the Council, e.g. expenditure on minor IT or equipment. This expenditure should have been transferred to the Comprehensive Income and Expenditure Statement (CIES) in the year during which it is incurred, along with any grant funding. A significant proportion of this amount relates to expenditure undertaken by schools on small projects, such as purchase of IT, or maintenance of schools and other property that has not been transferred to revenue. *Management have asserted that this balance should not affect the Council's Useable Reserves figure, since the funding source for this spend is from Capital Maintenance, or Capital Financing Grants. Therefore the funds could not have been spent completely at the discretion of the Council. We are currently seeking evidence to confirm this statement.*
Revenue Expenditure Funded by Capital Under Statute (REFCUS)	-42,358	Expenditure on assets that are not owned by the Council, such as Academies. This expenditure should have been transferred to the CIES in the year during which it was incurred.
TOTAL	**-152,787**	

At this stage management believe that the adjustments above affect the Usable Reserves figure disclosed in the prior year's financial statements. At this point we concur with this with the possible exception of the £11.3m "revenue" items above, where we are seeking additional evidence. However we will update the committee as part of the meeting.

It has also been noted that the majority of the £153m adjustment to the draft above relates to pre 2013/14, although circa £2.3m related to 2014/15 and £1.7m related to 2013/14. The 2013/14 and 2014/15 impacts should technically be reported as adjustments to those years' figures in the accounts. However, as the impact on both of these years individually and collectively appears immaterial, management have elected to post these adjustments to the updated 2014/15 accounts as part of the prior period adjustment above. We will therefore report this as an Uncorrected Misstatement in our final ISA260.

There are also other consequential adjustments that should be made as a result of the Prior Period Adjustment, such as to depreciation charges. Management believe these to be immaterial, and as such are not planning to make further adjustments to reflect these. We will need to see evidence to support that assertion, and again will report this as an Uncorrected Misstatement in our final ISA260.

Disclosures

We are liaising with management to agree the appropriate wording of both the comments in the AGS and the new Prior Period Adjustment note in the accounts. We will continue to refine this as work is completed and will again update the Committee on this at our meeting. There are no issues of disagreement on these areas though that we need to report.

When our audit work is finalised we will also perform our final work to check that all the expected adjustments have bene properly reflected in the final draft accounts.

AUC Overall Summary

The Balance Sheet included in the draft accounts for 2014/15 published on June 2015 included Assets Under Construction of £189.1m. Further detailed work, undertaken after the publication of the draft accounts, has identified that Assets Under Construction at 31 March 2015 totalled £36.3m. The majority of the difference related to transactions occurring between 2006/07 and 2012/13 and has therefore been account for as a prior period adjustment.

Additional disclosure has been made in the year end accounts to reflect this adjustment, including the addition of a Prior Period Error note, update of the Property, Plant and Equipment (PPE) note, update of the accounting policy note and additional wording added to the Annual Governance Statement (AGS) to explain the significant governance issue. We have received the proposed updated balances/wording from management and are currently reviewing these. We will give an oral update as part of the committee meeting.

Closing out the 2014/15 accounts

Subject to the above, as noted above all other outstanding work on the 2014/15 council and pension accounts is completed and is just going through our final review/completion procedures. Therefore once the AUC issue is resolved we will be in a position to issue our opinion on the accounts.

To summarise the remaining parts of the process, as we see it today, is as follows:

1. PwC to finalise our testing on the proposed £151m adjustment and the adjustments made to the accounts, plus reviewing the proposed revised wording in the AGS & accounts.
2. The wording of the notes are to be reviewed by the PwC technical team on Mon 23rd November for approval, along with updating our consideration of the need to qualify the accounts based on our work to date an expected findings.
3. The Council then to update the required notes in the accounts.
4. Hopefully, if no issues arise from our remaining testing, then the audit committee can then approve the accounts for signing (subject to any last minute formatting changes etc.)
5. PwC update and issue final ISA260 report.
6. The Council sign the accounts and the management representation letter
7. PwC then complete our final completion procedures, perform our testing on the Whole of Government Accounts and then sign our opinion.

We will work with the Council to ensure that, following the completion of our testing, the remaining parts of the process are completed as quickly and efficiently as possible.

This report has been issued in draft and therefore findings are subject to amendment or withdrawal. Our definitive conclusions will be those contained in the final report.

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