CORPORATE GOVERNANCE AND AUDIT COMMITTEE

16TH SEPTEMBER 2016

SUPPLEMENTARY PACK

AGENDA ITEM 8 –
Approval Of The Audited Statement Of Accounts And KPMG Report

- Revised pages 10, 13 and 21 of the KPMG report

This page is intentionally left blank

ITEM 8

Significant audit risks

Page 1

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our External Audit Plan 2015/16, presented to you in March 2016, we identified one significant risk affecting the Authority's 2015/16 financial statements. We have now completed our testing of this area and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority.

Significant Risk

Risk

In 2014/15 valuation of PPE was £3.9bn. This is a very material value on the balance sheet and is an estimate based on professional judgement by your in-house valuers. We did see changes to the draft accounts in both 2014/15 when the value of schools was amended following an internal review and 2013/14 when the valuation update was not completed before production of the draft accounts in July.

Findings

During our audit we evaluated the reliability and professional competence of the in-house and external valuer, as management's expert, to consider whether we could rely on their work. We concluded that the valuers have the professional competence, experience and objectivity to provide a valuation of PPE that we can rely on. We also tested a sample of revalued assets to confirm the value of the asset on the fixed asset register reconciled to the valuation report at the date the asset was revalued and the accounting entries were processed correctly in accordance with the Code.

We identified one issue over the valuation of the PFI Residual Waste Treatment Facility disclosed in Note 9 at a cost of £138.8 million which was new in 2015/16. When new assets are completed, buildings are often subject to impairment because the costs of building are often greater than the valuation. Your internal valuers considered the need for an impairment on the Waste Treatment asset concluding that build costs in the PFI model were the most relevant piece of information on which to base the valuation. The professional body RICS, currently do not provide any build cost indices to carry out a full DRC valuation for such a specialised asset. The Council's expert considers that when fully operational for a number of years, there will be clearer evidence in which to consider other valuation methodologies such as an income based approach when this is known. In the absence of a detailed valuation of the completed asset, we have identified from the PFI contractors financial model the breakdown of the PFI asset cost. From this, we consider that £13.6 million of the total cost might relate to bid costs and capitalised interest which is typically likely to be impaired during a full DRC (Depreciated Replacement Cost) valuation. However this work is not finalised.

We have asked management to make a specific representation in respect of this asset to confirm their view of the correct valuation methodology and made a recommendation for a detailed valuation to take place.

Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:

Level of prudence

Audit difference	0	1	2	3	4	5	6	Audit difference
	Cautious			Balanced			Optimistic	

Acceptable range

Assessment of subjective areas

Asset/liability class	15/16	14/15	Balance (£m)	KPMG comment
Provisions	3	3	£30.5 million *(PY: £38.4 million)*	Provisions have reduced by £7.9m. This mostly relates to the reduction in the provision for appeals against business rates valuations due to the settlement of outstanding claims. We have reviewed the basis for the calculation for each new provision and consider the provision disclosures to be proportionate and management's judgment to be balanced.
Property, Plant and Equipment (valuations / asset lives)	6	3	£4,124.5 million *(PY: £3,854.8 million)*	The overall value of PPE has increased by £269.7m. This increase mostly relates to capital additions in year of £471.2m offset by depreciation of £148.5m, however the net effect of the revaluation in year was an uplift of £25.6m. The majority of assets are revalued by an internal valuer. From our review of your approach to re-valuation and impairment of assets and the reliability of the valuers work, we concluded that a complete list was provided to the valuer and the assumptions used by the valuer were appropriate. As previously discussed in the section on significant risks we identified one specific valuation where we considered the Council's approach to be optimistic for the PFI Residual Waste Treatment Facility which is disclosed in Note 9 at a cost of £138.8 million in 2015/16. Your internal valuers considered the need for an impairment concluding that build costs in the PFI model were the most relevant piece of information on which to base the valuation. The professional body RICS, currently do not provide any build cost indices to carry out a full DRC valuation for such a specialised asset. The Council's expert considers that when fully operational for a number of years, there will be clearer evidence in which to consider other valuation methodologies such as an income based approach when this is known. In the absence of a detailed valuation of the completed asset, we have identified from the PFI contractors financial model the breakdown of the PFI asset cost. From this, we consider that £13.6 million of the total cost might relate to bid costs and capitalised interest which is typically likely to be impaired during a full DRC (Depreciated Replacement Cost) valuation. However this work is not finalised.
Pensions	3	3	£961.5 million *(PY: £1,005.8 million)*	The net pension liability has decreased by £44.3m – a decrease of 4%. We reviewed the assumptions underlying the Actuary's valuation of the Authority's pension liability. Our Actuarial specialists concluded that all the financial assumptions used by the Actuary fell within an acceptable range. We have therefore assessed this to be a balanced judgement.

Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Page 3

Priority rating for recommendations					
1	*Priority one*: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	*Priority two*: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	*Priority three*: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	2	**Related Party Transactions** There is no process to identify transactions between the Authority and commercial organisations that are related to councillors or senior officers as part of the accounts process. Audit testing was carried out in 2015/16 to ensure that there were no such transactions that were material to the Authority or the related party required disclosure **Recommendation** We recommend that the council reviews such transactions as part of the accounts process.	**Management Response** The Authority's current approach to the disclosure of related parties for Members and Senior Officers was agreed with a previous KPMG team some years ago, as part of the drive to encourage simpler local authority accounts. Given the change in emphasis from the current KPMG team, the Council will review its approach to the disclosure of related parties for the 2016/17 accounts. **Responsible officer** Principal Financial Manager May 2017.
2	2	**Valuation of the PFI Residual Waste Treatment Facility** A detailed valuation needs to take place on a Depreciated Replacement Cost basis and supported by an appropriate valuation certificate.	**Management Response** Officers will consider the need for a detailed valuation as part of the 2016/17 financial statements preparation. Principal Financial Manager May 2017.