Public Document Pack

Audit Committee

Extraordinary meeting – 31 July 2018

Supplementary Information

Agenda item 4:
BDO (external auditor) audit progress report
(audit for the year ended 31 March 2018)

BRISTOL CITY COUNCIL

AUDIT PROGRESS REPORT

Audit for the year ended 31 March 2018

31 July 2018

CONTENTS

OVERVIEW AND OUTSTANDING MATTERS

This summary provides an update to the Audit Committee on progress against our audit plan and our findings so far in key areas. We are continuing to work with Council Officers to finalise our outstanding queries and to complete our audit testing.

The following matters are outstanding at the date of this report. We will update you on their current status at the Audit Committee meeting at which this report is considered:

1	Clearance of outstanding issues on the audit queries tracker currently with management, including queries in relation to: • Fees and charges income (evidence in relation to the completeness and existence of income around the year end) • Grant income (evidence in relation to performance conditions of some grants) • Expenditure (outstanding sample items) • Explanations for movements in relation to Housing Benefit claims • Creditors (evidence to support the existence of creditors)
2	Responses from the actuary relating to mortality assumptions out of range ((see detail in Significant Risks update).
3	Completion of work relating to valuation of Property, Plant and Equipment that had not been revalued and to Investment Properties where errors had been identified (see detail in Significant Risks update).
4	Completion of work relating to the NNDR appeals provision (see detail in Significant Risks update).
5	Clarifications in respect of the exit package for the former Chief Executive
6	Use or Resources: draft outturn report for period 2 2018/19
7	Completion of final element of going concern assessment
8	Completion of Manager, Partner and Quality Reviewer reviews and addressing any points arising
9	Review and Technical clearance of final adjusted Statement of Accounts
10	Management letter of representation, to be approved and signed

PROGRESS IN SIGNIFICANT RISK AREAS

AUDIT RISKS

Below we set out how these risks have been addressed and the outcomes of our procedures to date.

Key: ■ Significant risk ■ Normal risk ■ Other issue

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
1	Management override of controls	Auditing standards presume that a risk of management override of controls is present in all entities and require us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual. By its nature, there are no controls in place to mitigate the risk of management override.	We have: • Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements • Reviewed accounting estimates for biases and evaluated whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud • Obtained an understanding of the business rationale for significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.	• Our audit work in relation to journals has not identified any significant issues with the appropriateness of journals posted by management. • Our work on management estimates has largely focused on the valuation of property, plant and equipment, investment properties and pensions assumptions, as well as NDR appeals provisions. Details of our progress in these specific areas can be found below. • No significant accounting transactions outside the normal course of business were noted from our work. **Outstanding work** We have outstanding work in respect of pensions assumptions, property, plant and equipment and investment properties as noted below.

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
2	**Risk of Fraud in Revenue Recognition**	Under auditing Standards there is a presumption that income recognition presents a fraud risk. In particular, we consider there to be a significant risk in respect of the existence (recognition) of revenue and capital grants that are subject to performance and / or conditions before these may be recognised as revenue in the comprehensive income and expenditure statement (CIES). We also consider there to be a significant risk in relation to the existence of fees and charges income from adult social care, recorded in the CIES with a particular focus on year-end cut off.	We tested a sample of grants subject to performance and / or conditions to confirm that conditions of the grant have been met before the income is recognised in the CIES. We tested a sample of fees and charges to ensure income has been recorded in the correct period and that all income that has been recorded should have been recorded.	We have completed the majority of our work in this area and at the time of writing, have not identified any issues with the Council's recognition of income. **Outstanding work** We are awaiting receipt of supporting documentation from the Council for a number of sampled items of supporting information relating to grant recognition. We are awaiting receipt of supporting documentation from the Council for a number of sampled items in supporting information relating to income being recorded in the correct period. We are unable to form a conclusion in this area until these items are received, have been assessed and concluded upon.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
3	Valuation of Property, Plant and Equipment and Investment Properties	Management uses external valuation data to assess whether there has been a material change in the value of classes of assets. Investment properties are revalued annually according to market conditions at year-end. Higher value operational properties (other land and buildings and dwellings) are revalued annually to provide assurance that carrying values are materially stated, with the remainder of non-material value assets revalued periodically (minimum of every five years). Operational asset valuations are undertaken by both external and internal valuers. We consider there to be a risk over the valuation of land buildings, dwellings and investment properties where valuations are based on market assumptions or where updated valuations have not be provided for a class of assets at the year-end. *(This has been increased from a normal risk to a significant risk due to volatility and uncertainty over market prices in the year)*	We reviewed the instructions provided to the valuer and review the valuer's skills and expertise in order to determine if we can rely on the management expert. We confirm that the basis of valuation for assets valued in year is appropriate based on their usage. We confirm that an instant build modern equivalent asset basis has been used for assets valued at depreciated replacement cost. We reviewed the movements in valuations with other relevant market indices to assess the reasonableness of the valuations.	From our review of the instructions provided to the valuer and assessment of the expertise of the valuer, we are satisfied that we can rely on this work. For the sample of PPE assets and investment properties reviewed we are satisfied that the basis of the valuation for each asset is appropriate and that the revaluation movements are not materially misstated. Regarding investment properties we have noted an extrapolated error in relation to the value of investment properties, due to the Council using the incorrect yields in a number of cases. **Outstanding work** We are working with the Council to agree the impact on valuation as a result of property, plant and equipment items which have not been valued at the balance sheet date. Our current expectation is that this will lead to a reportable unadjusted error. In addition, we are in the process of agreeing the impact on the value of investment properties, due to errors already identified. This may also lead to a reportable unadjusted error.

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
4	**Pension liability assumptions**	The pension liability comprises the Council's share of the market value of assets held in the Avon Pension Fund and the estimated future liability to pay pensions. An actuarial estimate of the pension fund liability is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation. Management has agreed the assumptions made by the actuary to support the estimate and these are disclosed in the financial statements. There is a risk the valuation is not based on accurate membership data or uses inappropriate assumptions to value the liability.	We agreed the disclosures to the information provided by the pension fund actuary. We requested assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary. We checked whether any significant changes in membership data were communicated to the actuary. We reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data.	We did not identify any issues regarding the accuracy of the disclosures in the financial statements. We obtained assurances from the auditors of the pension scheme regarding the accuracy of the membership data, subject to resolving outstanding queries as noted below. This assurance response letter was received from Grant Thornton on 24 July 2018. We have reviewed the assumptions used by the actuary in valuing the pension liability. In particular, we have considered the findings in the PwC report and have noted that assumptions were within the expected range, with the exception of the mortality assumptions. Three of the four mortality assumptions used are outside of the range of values submitted by the actuary, Mercers, to PwC to enable PwC to assess the reasonableness of the assumptions used. Consequently, PwC's assurances do not cover the mortality assumptions used for Avon. We have asked the Council to contact the actuary to obtain an explanation for this deviation. **Outstanding work** We have made enquiries of the scheme actuary, regarding the mortality assumptions. If we do not receive satisfactory explanations, it will be necessary to commission an expert review of the impact of these assumptions on the fund for the Council Until this resolved we are unable to conclude on this area.

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
5	**Risk of Fraud in Expenditure Recognition**	As a public sector body, the presumed risk of fraud in revenue recognition is extended to include the risk of fraud in revenue recognition. There is a risk that management defer expenditure into the following year in order to present a more favourable outturn and to balance the budget.	We have performed enhanced testing of expenditure recognised either side of the year end, to ensure this has been correctly recorded in the accounting period.	Our testing of expenditure and payments made around the year-end has not identified any issues with accounting for expenditure in the correct period so far. **Outstanding work** We have several items of expenditure that we are still awaiting documentation from the Council to confirm that amounts have been recorded in the correct period. We are unable to form a conclusion in this area until these items are received.
6	**Non-domestic Rates Appeals Provision**	Billing authorities are required to estimate the value of potential refund of business rates arising from rate appeals, including backdated appeals. The Valuation Office Agency (VOA) provides information regarding the appeals currently being assessed and settled. Management use this information to calculate a success rate for specific business types for settled appeals, and applies an appropriate rate to each type of business appeal still outstanding at year end. We consider there to be a risk for all authorities in relation to the estimation of the provision due to potential incomplete data and assumptions used in calculating the likely success rate of appeals.	We have reviewed the accuracy of the appeals data to confirm that it is complete based on the VOA list, and that settled appeals are removed. We have reviewed and tested the assumptions used in the preparation of the provision estimate.	The value of the appeals provision has increased from £11.1 million to £23.7 million. This is partly due to the Council being on the pilot scheme whereby they retain 100% of the business rates, but also bear 100% of the risks around appeals. **Outstanding work** We are finalising our audit of this area.

KEY AUDIT AND ACCOUNTING MATTERS

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
7	Group Accounts	The Council has a range of interests in various entities including its wholly owned subsidiaries, Bristol Holdings, Bristol Waste and Bristol Energy. The increase in the scale of these entities led to the aggregate of these entities becoming material in 2016/17 and the requirement to prepare group accounts. Bristol Energy is currently loss making and, as in 2016/17, we will need to consider whether the Council's investment in the subsidiary is held at the correct value.	The Council has concluded that group accounts will be required for 2017/18 and is communicating with the subsidiaries to ensure that the necessary information is available and in good time. We will communicate with the auditors of the subsidiaries and as auditor of the Bristol City Council Group, will issue instructions to PwC, the auditor for each of the subsidiaries. We will review the Council's investment in Bristol energy, using our valuation specialists to challenge the value in the financial statements.	We have recently received returns from the auditors of Bristol Holdings Limited, Bristol Waste and Bristol Energy. No issues have been brought to our attention by the subsidiary auditors that would have a material impact on our opinion. We note that during the year, the valuation of Bristol Holdings has been impaired by £12m. Initially this was split out between a prior year impairment of £7m and a current year impairment of £5m in the draft financial statements. However, we do not consider it necessary to recognise an impairment in the prior year and therefore this has been corrected in year. We will review this correction in the final version of the accounts. The calculation of the value in the subsidiary companies (and therefore the impairment required) is still under review and our valuations experts are considering the Council's methodology in arriving at a value. We have also identified that the Council has incorrectly been treating its investment in subsidiary companies due to the different treatment of investment in ordinary shares and investment in preference shares. **Outstanding work** We have been provided with a working paper by the Council outlining the impact on the impairment. Once we have reviewed this in conjunction with the results of our valuers work we will be in a position to form a conclusion in this area.

	AUDIT AREA	RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	AUDIT FINDINGS AND CONCLUSION
8	Consideration of related party transactions	We need to consider if the disclosures in the financial statements concerning related party transactions are complete and adequate and in line with the requirements of the accounting standards.	We have reviewed the related party transactions identification procedures in place and the relevant information concerning any such identified transactions. We will discuss with management declarations to ensure that there are no potential related party transactions that are not disclosed. This is also something we will require you to include in your management representation letter.	No significant issues were noted from our work

OTHER AREAS

AUDIT AREA	AUDIT FINDINGS	WORK TO COMPLETE
Heritage Assets	The Council holds £201 million of heritage assets at the balance sheet date (an increase of around £100 million from the prior year). For a sample of asset we agreed their physical existence and their value to the insurance company valuation. The significant increase in valuation was due to the Council engaging a new insurer who undertook a more thorough valuation exercise, resulting in a considerable volume of assets being valuedin the year that had not been valued before. As a result, the Council have made a prior period adjustments to recognise £98 million of assets which were omitted from the valuation last year.	To review the adjustment and disclosures in the final set of accounts
Severance payment in respect of the Chief Executive	Our work is ongoing on this matter.	We are awaiting clarification from officers relating to interpretation of the employment contract. Until we have received this, we cannot conclude on this issue. This issue also impacts on our work relating to Use of Resources.

USE OF RESOURCES

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money) and report to you on an 'except for' basis. This is based on the following reporting criterion:

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

There are three sub criteria that we consider as part of our overall risk assessment:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties.

We reported our risk assessment, which included use of resources significant risks, in the 2017/18 Audit Planning Report issued on 20 March 2018. We have since undertaken a more detailed assessment of risk following our completion of the interim review of financial controls and review of the draft financial statements and we have not included any additional significant risks.

We report below our findings of the work designed to address these significant risks and any other relevant use of resources work undertaken.

Key: ■ Significant risk

RISK AREA		RISK DESCRIPTION AND WORK PERFORMED	AUDIT FINDINGS AND CONCLUSION
1	Sustainable finances (SR)	In our audit plan, we identified sustainable finances as significant risk area. In 2017, the Council agreed to implement savings proposals designed to reduce net expenditure by more than £30 million in 2017/18. At 31 December 2017 (month 9) the Council was forecasting an adverse variance against the savings plan of approximately £3.1 million which were classified as being “at risk”. The implementation of the savings proposals is part of a longer-term plan to deliver financial sustainability of the Council and further savings proposals are planned for the period to 31 March 2022. The savings plan was agreed by the Council in February 2017 when it was evident that the Council was likely to incur a 2016/17 budget deficit. This 2016/17 deficit amounted to approximately £10 million and was one factor in the decision to modify our 2016/17 conclusion on the use of resources. The Council’s financial monitoring arrangements have been subject to significant strengthening over the past eighteen months. Despite elements of the savings plan being at risk, at month 9, the Council is forecasting a small underspend against its 2017/18 budget. In August 2017, the Council agreed a new medium term financial plan (MTFP) which set out the cost pressures faced by the Council and also identified areas where the Council could develop funding. For example, the Council plans to support the construction of 2,000 homes per year, which will impact upon the Council’s income in the form of the New Homes Bonus and also increase the yield from Council tax in the City. The plan sets out how the Council will achieve a balanced budget over the next four years. Given a background of reduced levels of grant income combined with increased service demands, sustainable finances remains as a significant risk for our audit. In addressing this risk in 2017/18, we looked at the assumptions underlying the current MTFP; looked at the Council’s financial monitoring process for 2017/18; and looked at the process for initiating, approving, implementing and monitoring savings plan proposals.	Over the term of the current MTFP, there is a funding gap of £42m. A savings plan was produced at the same time, which allowed for the budget to be balanced in the short term, including for 2018/19, although additional savings were required in order to balance the budget in the medium term. The budget was balanced in 2017/18, even though £8m of forecast savings were not delivered. This was achieved by achieving offsetting savings elsewhere and through the use of non-recurring income and contingencies that were built into the budget. The next round of medium term financial planning is well under way, as this started with the 2018/19 budget exercise. This included producing an updated savings plan. In the plan, the savings undelivered in 2017/18 have been rolled forward, plus additional savings have been identified to eliminate the budget gap over the course of the next MTFP period (i.e. to 2022/23). We have some residual queries in respect of budget monitoring and we will conclude on whether arrangements for the use of sustainable finances were adequate or not once we have resolved these queries.

RISK AREA		RISK DESCRIPTION AND WORK PERFORMED	AUDIT FINDINGS AND CONCLUSION
2	Informed decision-making (SR)	In our audit plan, we identified informed-decision-making as a significant risk area. Following concerns around the forecast budget deficit in 2016/17, the Council commissioned an independent review of its arrangements. The Bundred Report (issued in February 2017) identified a range of areas for the Council to address. In our 2016/17 audit we were able to confirm that significant steps had been taken to improve the arrangements but that for parts of 2016/17 the arrangements were inadequate. Accordingly we issued an adverse conclusion on the Council's use of resources. In addition, we also had concerns about the transparency of the operations within the Council's subsidiaries and whether members received the financial information that they needed to ensure effective oversight. In response to the findings within the Bundred Report, the Council has responded and has taken many steps to address weaknesses. While it is evident that significant progress has been made, the arrangements to ensure informed decision making arrangements are in place remains a significant risk for our audit. To assess the arrangements in 2017/18, we looked at the council's financial monitoring process and governance arrangements; looked at arrangements in place for monitoring and reporting the savings achieved against those forecast in the savings plan; reviewed the Council's progress in implementing the recommendations of the Bundred Report; and refreshed and updated our understanding of the governance arrangements in place in respect of the Council's material subsidiaries.	The Council's governance arrangements have evolved since the prior year. Reports on financial performance are reviewed and challenged by the Mayor before going to Cabinet. Additionally, the Oversight & Scrutiny Management Board also receive the monthly financial monitoring reports and their role is to keep "an overview of Council business including scrutinising areas of particular interest or concern, holding the Executive to account for the decisions that are made, and assisting in the development and review of Council policy." In respect of the savings plan, £8m of the forecast savings of £32m were not delivered during 2017/18. These were offset by savings achieved elsewhere and through the generation of non-recurring income. The budget was balanced in 2017/18 as a result of the above and we have reviewed the process in place for identifying and implementing savings schemes. We found this to be a robust and tightly controlled process. In respect of the Bundred Report, 73 of the 85 recommendations (86%) had been implemented by 30 June and the Council are on course to implement all the recommendations by the end of the financial year 2018/19. In respect of the Council's material subsidiaries, 2017/18 was the first full year of operation of the shareholder oversight group. This group's aim is not only to improve oversight over these subsidiaries, but also to foster closer links with their respective Boards. The group has carried out a governance review and this has highlighted some areas of improvement, which are being followed up by using a detailed action plan. We have some residual queries in respect of budget monitoring and, as noted above, are awaiting clarification from officers in connection with the severance payment made to the Chief Executive. We will conclude on whether arrangements for informed decision-making are adequate once we have resolved these queries.

FOR MORE INFORMATION:

David Eagles
Engagement lead

T: +44(0)1473 320728
M: +44(0)7967 203431
E: David.Eagles@bdo.co.uk

Donald Plane
Director

T: +44(0) 2380 881 810
E: donald.x.plane@bdo.co.uk

Chris Wlaznik
Manager

T: +44 (0)117 9306728
M: +44 (0)7970 115223
E: Chris.Wlaznik@bdo.co.uk

The matters raised in our report prepared in connection with the audit are those we believe should be brought to the attention of the organisation. They do not purport to be a complete record of all matters arising. No responsibility to any third party is accepted.

BDO LLP is a corporate establishment under the Limited Liability Partnership Act 2000 and a UK Member Firm of BDO International. BDO Northern Ireland, a separate partnership, operates under a licence agreement. BDO LLP and BDO Northern Ireland are both separately authorised and regulated by the Financial Conduct Authority to conduct investment business.

www.bdo.co.uk