HERTFORDSHIRE COUNTY COUNCIL

Agenda Item No:
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AUDIT COMMITTEE
26 MARCH 2018 AT 10.00 AM

UPDATE ON PREPARATIONS FOR 2017/18 AUDIT

Report of the Director of Resources

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1. Purpose of the Report

1.1 To update the Committee on actions taken in preparation for the 2017/18 Statement of Accounts.

2. Summary

2.1 Ernst Young LLP (EY) issued an unqualified opinion on the 2016/17 accounts, and made no specific recommendations. As reported previously, a number of actions are under way to ensure the 2017/18 accounts and audit achieve the same high standards, and to address new timescales. This report provides an update of progress against these actions.

3. Recommendations

3.1 The Committee is invited to note and comment upon this report, specifically

- Noting the preparation for the 2017/18 accounts close and audit, in particular the earlier deadlines to be achieved in 2017/18 for draft accounts and audit conclusion,
- Noting a potential delay in the internal EY sign off for issuing the 2017/18 audit plan, that this is unfortunate but unavoidable and the EY team are seeking to minimise any delay, and that Herts Finance officers have reviewed the risks arising and are confident that they will not jeopardise the overall timetable,
- Noting that there are no significant changes required to the accounting policies for 2017/18,
- Noting the intention to move from 'group entity' to 'single entity' accounts in 2017/18, but to hold this under annual review for future years.

4. Actions to prepare for 2017/18 and subsequent audits

4.1 Finance has continued to build on the outcomes of the review of the 2016/17 accounts closure and audit process, as it develops its plans for the 2017/18 close.

4.2 From 2017/18, there is a statutory requirement to produce the draft accounts by 31 May and final audited accounts by 31 July. A detailed project plan and timetable was prepared for 2016/17 closure, to provide a 'dry run'. This plan was successfully delivered, and places the Council in a good position to tackle the revised deadline for this year. As last year, a number of tasks have been brought forward to help achieve this, for example earlier delivery of asset revaluations and actuary estimates.

4.3 Herts Finance are also continuing to work with EY on ways of streamlining and bringing forward the audit process. These include early testing of April – December 2017 transactions, and the agreement of accounting policies and changes to the format of accounts before the main audit. There has been an increase in the level of substantive testing being requested by EY, which is in part a response to the higher level of overall risk currently being faced in the local government sector. Herts Finance is responding to this as necessary and keeping the overall workload under review.

4.4 Officers have attended joint CIPFA / EY training covering the 2017/18 accounts. There are no substantial changes to the accounting requirements this year, which will help facilitate the achievement of the earlier deadlines that are required.

4.5 The summary timetable for the preparation of the accounts is set out below. A detailed timetable is held by the finance team and will help monitor progress to the 31 May 2018 deadline.

Action	Date
Outturn Monitor and final Carryforwards due to Corporate Finance	Wed 25/4/18
Outturn Monitor due to SMB (presented on Tues 8th)	Thurs 3/5/18
Draft Statement of Accounts to Director of Resources for review	Thurs 24/5/18
Draft Statement of Accounts final proof read	Tues 29/5/18
Draft Statement of Accounts to EY	Thurs 31/5/18

5. Audit plan

5.1 It is usual for EY (as the independent external auditor) to bring forward an audit plan at this point in the year covering the audits of both the Hertfordshire County Council accounts and the accounts of the pension fund. The purpose of this plan is to advise the Committee how the EY team will progress audit testing in line with the national deadlines, and to indicate any specific areas of focus. Specific focus may be due to local or national issues.

5.2 The EY audit plan is separate to the Herts Finance plan for delivery of the draft accounts. Neither plan is dependent on the other, although they are inter-related will work to the same deadlines and principles.

5.3 Substantive testing is always done ahead of the formal audit undertaken in April and May. This testing includes reviews of internal audit reports, and of financial system controls and transactions. This ‘managed’ approach to the audit has proceeded uninterrupted and as usual for the 2017/18 financial year. Substantive testing has been concluded already at a greater level of detail than is usual (as part of a move away from controls based testing to a focus more on substantive testing), generating more work for the Herts Finance team. Outcomes to date have been positive. There is a strong and ongoing dialogue between the audit and finance teams, and some small changes have been made to the Herts Finance plan to reflect this interim work.

5.4 It is understood by the Herts Finance leads that the EY audit plan has been prepared in a timely way by the EY team. However, two key factors have delayed the internal EY sign off of this plan, with the result that discussion with officers and potentially presentation to the committee has been delayed.

5.5 The factors delaying the formal presentation of the audit plan are

- Selection of the EY audit of Hertfordshire County Council as part of an internal review by EY, part of a review of higher profile engagements (such as Hertfordshire County Council). This work is understood to have been recently completed, and has required some additional checking between EY teams to ensure that any points arising from the review are fully reflected in the audit plan.

- Selection of the EY audit of Hertfordshire County Council by the Financial Reporting Council (FRC), again due to the profile of this account. In accordance with EYs contract with Public Sector Audit Appointments (PSAA), a sample of audit engagements are reviewed every year by the FRC. For 16-17, Hertfordshire County Council was one of the engagements selected. This is an external review of EY by a sector regulator, and at the date of this report, this review is ongoing (we expect a final report will not be issued to the EY audit team by 26 March; it is expected towards the end of April).). Again, the EY audit plan is being cross-referred and quality assured to address outcomes of this review.

5.6 In this context, the formal internal EY approval of the plan has been delayed whilst the necessary cross checks, outlined above, are concluded. Even though the unfortunate coincidence of both an internal and an external review of the same audit engagement immediately prior to presentation of the plan has been frustrating for both teams, it does offer the added assurance that the audit plan, when presented, has been subjected to thorough review and detailed testing. At the 26 March Audit Committee, EYs Engagement Lead can provide an update to the Audit Committee on the current position with the reviews and the scope of the 2017-2018 audit.

5.7 Herts Finance lead officers have reviewed the risks arising from this situation and discussed them with the EY leads. Given the independence of the two plans, and the progress made on the interim testing, it is considered that the delay to the submission of the audit plan is a low risk that is substantially mitigated.

5.8 The additional testing work required and the provision of further evidence and testing by the Herts Finance team has been substantial, but this is now largely concluded. We have sought and received assurances that the overall audit fee will not be affected.

6. Accounting Policies

6.1 Officers have reviewed the Accounting Policies to ensure these remain compliant with relevant accounting standards, and that accounting practice in preparing the accounts is aligned with policies.

6.2 There are no changes in accounting standards or other statutory requirements that impact the Council's 2017/18 accounts, and therefore no changes to accounting policies are proposed. However, we are reviewing disclosures on 'critical judgements' (that is, areas of higher complexity or areas affected by uncertain future events), including our assessment of future funding and resilience.

7. Group accounts

7.1 Further to a review of the critical path required to deliver earlier accounts for 2017/18, it has been identified by the finance team and reviewed by the external auditor that the group accounts prepared in previous years are of limited materiality and do not significantly enhance the quality of the accounts as a whole. As a result, it is intended that single entity accounts are prepared for 2017/18. However, it is a requirement to review the position on group accounts preparation every year, and so this position may be reversed depending on the development of Council activities in the future. Further detail on this is included at appendix A

8. Financial Implications

8.1 There are no additional financial implications.

Appendix A – rationale for adoption of single entity, rather than group, accounts

Assessment of Group Accounts for Hertfordshire County Council

Hertfordshire County Council undertakes an annual assessment to review its investments in companies and determine if a group boundary exists. This review uses the standard determination of group status provided in the national Code of Practice for local government accounts.

Since the inception of Herts Catering (HCL) and Herts for Learning (HfL) in September 2013, the Council has determined that a group boundary exists for both, and consequently has produced Group Accounts (from the 2013/14 financial year), although it has been recognised that this is primarily a technical accounting consideration due to the size of both organisations in comparison with the overall size of the Council.

However, having undertaken a further review of these entities, we are minded to no longer produce Group Accounts. Whilst we are happy in principle with the technical assessment that a group boundary exists, the Council does not believe the adjustments required to produce Group Accounts

1. are material in nature, or
2. enhance the overall value and clarity of the accounts for stakeholders.

The requirement for provision of group accounts is as follows. International Accounting Standard 1 sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. Furthermore, within International Financial Reporting Standard 10 - Consolidated Financial Statements, there are requirements for the preparation and presentation of consolidated financial statements, requiring entities to consolidate other entities it controls.

However, the primary consideration is the principal of materiality. The definition of materiality[1] is:

> *“Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity’s financial report.”*

The Code of Practice expands on this further and Paragraph 2.1.2.11 of the Code further states that an authority need not comply with the Code, as to both disclosure and accounting principles, if the information is <u>not material</u> to the true and fair view of the financial position, financial performance and cash flows of the authority and to the understanding of users.

Put simply, providing group accounts for Hertfordshire County Council does not enhance the reader’s understanding of the financial position of the Council. So, while providing Hertfordshire County Council accounts in a ‘group’ format is technically correct, it does not significantly enhance the reader’s understanding of the County Council’s financial activity, and providing only a single entity statement does not risk misleading a reader of the accounts.

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[1] **From IFRS Practice Statement 'Making Materiality Judgements'**

It is also worth noting that this analysis has been discussed with the Independent External Auditor, and also that the preparation of group accounts is onerous, needing approximately 3 days of work.

As such, we are intending to produce only Single Entity accounts from 2017/18 (although this will be reviewed annually), but also to include a narrative disclosure outlining that a group boundary exists and explaining the rationale for not producing Group Accounts. The detailed supporting this is available.