HERTFORDSHIRE COUNTY COUNCIL

AUDIT COMMITTEE
18 JULY 2018 AT 2.00 PM

Agenda Item No:

4

2017/18 ERNST & YOUNG AUDIT UPDATE REPORT; HERTFORDSHIRE COUNTY COUNCIL RESPONSES

Report of the Director of Resources

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1. Purpose of the Report

1.1 The Purpose of this report is:

- to present to the Committee the Ernst and Young LLP (EY) Audit Update Report for the 2017/18 audit of the Council accounts completed to date, and

- the Council's responses to that report.

2. Recommendations

2.1 The Committee is asked to approve the recommendations of this report, subject to the remaining audit testing being concluded without further material changes being recommended. In the event that further adjusting items are identified, the Committee is asked to agree to delegate authority for the change to be made to the Section 151 Officer (Director of Resources), in consultation with the Chair (or Vice-Chair) of this Committee. Any such changes will be reported to Audit Committee at the next meeting.

2.2 The Committee is also asked to consider the treatment of the various adjustments to the accounts recommended by Hertfordshire County Council officers, and to clearly accept or reject the recommendation in each case.

2.3 The Audited Accounts included as appendix 2 to this report include the changes that have already been made to the accounts further to the work of the audit team, and as set out in section 5.

3. The content of the audit results report

3.1 Ernst Young (EY) have provided the Council with their Audit Update Report (appended as appendix 1) for the audit of the Council accounts for the financial year 2017/18. The deadline for concluding the audit is July 31, and some audit work remains outstanding (this is consistent with previous years).

3.2 The Audit Update Report will be followed by the formal Audit Results Report, which is a standard document reflecting the requirements of the audit standard (ISA260) that is updated for latest information each year. The Audit Results Report will be received by the Council in July, and formally considered by the Committee in September.

3.3 The EY Audit Update Report sets out the progress made against the items previously identified in the Audit Plan for the year and makes recommendations based on the findings of that review. This is predominately where changes to the figures in the accounts are recommended, but can also include process or controls changes. HCC officers then provide advice for the Committee on whether to accept the recommendations (adjust the accounts) or reject the recommendation of the auditor (leave the value unadjusted).

3.4 Recommended changes to the accounts are informed by the application of the guidance set out in the Code of Practice for Local Government Accounts (‘the Code’) and the materiality threshold determined by the auditor.

3.5 Materiality thresholds have been reviewed by the auditor and the Committee will recall that, for the Council’s accounts, all uncorrected misstatements greater than £1.78m will be reported to the Committee and that the overall materiality threshold has been raised to 2% materiality. (2% materiality means that there is a risk of qualification of the accounts if the total level of unadjusted items exceeds 2% of HCC turnover, which equates to £36m - items could be identified and recommended to be restated that are greater, but if that recommendation is accepted there is no further action required).

3.6 Progress towards the achievement of the earlier deadline for this year should also be noted by the Committee. The accounts were provided to the Auditor by the due date (31 May) and since 1 June the audit has proceeded as planned towards the audit sign off. The Committee will note from the report that some areas of testing remain to be concluded at the time of preparing the report (9 July) and are unlikely to be fully concluded by the date of the Committee meeting (18 July). There will then remain some 2 weeks before the deadline for conclusion of the audit (31 July).

3.7 It is therefore anticipated that the list of incomplete areas of testing set out in the report will substantially reduce by the time the Committee meets, but also that there may continue to be some areas of testing still incomplete at that date. Should any further adjusting items be identified it is proposed that relevant decisions are delegated to the Director of Resources (s151) in consultation with the Chair (or Vice-Chair) of the Committee. The final audit results report will be provided to the Council by 31 July and will be part of the Audit Committee agenda in September.

4. Context for the 2017/18 audit of the accounts

4.1 It is important to recall the context for this audit, which has been marked by a number of important events.

4.2 2017/18 saw an earlier deadline for closedown than previous years. Early work was undertaken by the Council to prepare for this, as previously reported, including:

- a 'dry run' last year,

- discussion with actuary on the best way to provide estimates on the value of the fund and the current value of the future liabilities of the pension fund, balancing earlier reporting and accuracy of estimates
- Finance staff attendance at the EY/CIPFA briefings on best practice in January and February 2018

4.3 Significant national issues also preceded the audit this year, including the collapse of Carillion and the later report to the Public Accounts Committee on the role of the audit firms involved, and the financial crisis seen at Northamptonshire County Council and the responses to that. These events influenced views on the role of the auditor and the relationship of the Council with the auditor.

5. 2017/18 audit – overview

5.1 Overall, good progress has been made; all deadlines have been achieved to plan, the accounts were under review by the Director of Resources (s151) 2 days ahead of plan, and the full accounts pack was ready several days ahead of the 31 May deadline. The subsequent audit review has progressed to time.

5.2 The substance of the Audit Update Report is positive – no fundamental issues have been identified and the auditor is confident that, subject to the conclusion of the outstanding areas of testing, an unqualified opinion is expected for both the accounts and the achievement of value for money in the use of resources.

5.3 However, a number of difficulties were encountered and areas where the audit approach (both from EY and HCC) would benefit from further review have been identified as a result. Pre-audit work in January and February 2018 saw a greater level of detail requested by EY than had been anticipated, including larger sample sizes and detailed substantive testing. Also, less reliance placed on internal audit (SIAS) reports prepared during the year results than in previous years (this appears to be a move away from a 'managed audit' approach and towards a great level of substantive testing).

5.4 A key issue has been the assessment of the value of pension fund assets. This is a complex area, because it involves valuing a range of investments made by third parties on behalf of the pension fund including bonds, equities and other investments, the value of which cannot be known with certainty without selling the asset. There is a necessity to work with estimated values, which are provided by the pension fund actuary. Extensive discussion was held with the actuary to secure a balance of timeliness and accuracy. The assets are often invested in areas where values fluctuate over a short period of time. Finally, the format of the pension fund accounts and of the Council accounts are fundamentally different in presentation and preparation, and governed by different guidance.

5.5 Previous audit reviews have focussed on the estimation methodology used by the actuary (the IAS19 assessment), and the reflection of these estimates correctly within the HCC accounts. The methodology has previously been found by the auditor to be reasonable and no recommendation for improvement has been made. No recommendation on the methodology has been made in the current year; indeed it has been considered to be valid and sufficient. This assessment identifies the values of fund assets to be attributed to different admitted bodies. (It is not used by the fund itself.)

5.6 The HCC share of the Hertfordshire LGPS assets amounts to c£2.3bn. A 1% change in the value of the overall fund would have a £23m impact on the valuation of the HCC share. Analysis of the results in the current and previous years shows that difference between reported asset values (arising from timing differences in estimates of those values) in previous years of +/-1.6%.

5.7 For the current year, EY have recommended that revised estimated values were requested from the actuary and then adjusted in the HCC accounts (see section 6 below). The auditor also contacted Hertfordshire District Councils to advise that it was recommended to make a similar adjustment in their accounts as well. The Committee is asked to note that this amounts to a £34.5m adjustment in the estimated value of pension fund assets attributable to HCC, a change of 1.7%. <u>This is not intended by the Council to set a precedent</u>; the approach to this estimate in future years will need to be discussed with the auditor, as Council officers have some concerns on the implications of this approach.

5.8 The Committee are asked to note that <u>there remains a significant margin for error</u> in the reported values and that these are not 'actual' values. The later estimate does provide a slightly higher level of overall accuracy, but some asset classes (especially overseas equity holdings) may not have been given a clear market value until later in July. It is unclear whether marginal changes (1.7%) in such estimates improves the overall quality of the accounts.

6. Specific EY Audit Recommendations and HCC Responses

6.1 Specific audit recommendations identified during the review are set out below. It is recommended in each case that the Committee approves accepting them. (There were also a small number of other changes, includes grammatical improvements).

Audit reference	Value of proposed adjustment	Commentary	Recommendation to the Committee to accept or reject the adjustment
Pensions Liability	£34,456k	Reduction in the Net Pensions Liability	Accept
Financial Instruments	£3,664k	Investment classification from Unquoted Equity to Financial Instrument held for Sale	Accept
Long Term Debtors	£307k	Reduction in the debtor recognised relating to Legal Charges	Accept
Property, Plant & Equipment – change in classification	£260k	Asset reclassified from Land and Buildings to Surplus Assets	Accept

7. Conclusions

- Recent events have put a particular focus on the financial standing of local authorities, the role of the auditor, and the overall statutory accounts process;
- It is intended to engage with local EY team well ahead of 2018/19 close to maximise the efficiency of this process.