Agenda Item No. 9

Audit Committee – 26 September 2016

Post – Audit Statement of Accounts 2015/16 including Annual Governance Statement and Audit Findings Report

1.0 Summary of report

This report presents the audited Statement of Accounts along with a summary of these, the council's letter of representation, which the council is required to provide to Ernst & Young, and is signed by the Chief Financial Officer and Chair of the Audit Committee.

1.1 Alongside the Statement of Accounts is the Annual Governance Statement.

1.2 Ernst & Young's Audit Findings Report on the authority's accounts is also attached.

2.0 Recommendations

2.1 Audit Committee are requested to:

1. Receive the audit findings report from Ernst & Young on their audit of the 2015/16 statement of accounts and consider the key messages (Appendix 1) and note that there have been agreed amendments made to the accounts during the audit.
2. Note, consider and endorse the letter of representation attached (Appendix 2).
3. Note and approve the post-audit statement of accounts for 2015/16 including the Annual Governance Statement (Appendix 3).
4. Note the summary of accounts (Appendix 4).
5. Approve the Chair of the Committee to sign and date the accounts as required under the Accounts and Audit (England) Regulations 2015.
6. Authorise the Chief Financial Officer (CFO) to distribute copies of the audited statement of accounts to partners and stakeholders alongside the Annual Governance Statement 2015/16.

James Walsh
Chief Financial Officer

15th September, 2016

3.0 Governance

3.1 Councils must produce annual accounts and an Annual Governance Statement in line with the Accounts and Audit (England) Regulations 2015. In addition, the act requires that the Chief Financial Officer and Chair of Audit Committee make accurate representations to their auditor in respect of the fair presentation of the accounts. The Committee is asked to approve the letter of representation attached (Appendix 2). The regulations require the statement of accounts and the Annual Governance Statement to be considered and approved by the appropriate Committee of the council, in this case the Audit Committee.

3.2 <u>Annual Governance Statement</u>

The Annual Governance Statement sits alongside the Statement of Accounts. The draft was received by Audit Committee in June 2016 and the final version, post audit, is attached for consideration and approval.

3.3 A report on the annual review of the effectiveness of the system of internal control was submitted to Audit Committee on 27th June, along with the draft Annual Governance Statement for 2015/16. Since that date, one further issue has arisen in relation to information governance. A data breach was reported involving letters and direct payment contribution statements sent out to the wrong addresses, the name on the letter and the statement information were correct but the address on each letter was incorrect. An internal risk assessment set the breach at a level 3 (high risk requiring formal investigation). As the breach related to Adult Social Care data there was also a requirement to report and assess it using the NHS tool as a Serious Incident Requiring Investigation (SIRI). The SIRI risk assessment set the breach at a SIRI level 2, requiring reporting to the Information Commissioner's Office (ICO). All internal containment is now complete and we are awaiting a response from the ICO. For the purposes of the AGS, it is not considered significant enough to include in the formal statement as a significant governance issue.

3.4 An update will be provided once a response from the ICO has been received.

4.0 Resource and Legal Considerations

4.1 As at 31 March 2016 the post-audit statement of accounts shows a net position of an under spend against budget of £0.701 million. General fund services, (including planned use of general reserves and transfers to and from earmarked reserves) has an overall surplus for the year of £2.617m. This results in net general reserves of £14.131m.

4.2 The audit process did not identify any material adjustments affecting the council's accounts; however the audit findings report from Ernst & Young (Appendix 1) outlines a number of misclassification and disclosure amendments. Although none of these have an effect on general fund reserves, the post-audit of statement of accounts (Appendix 3) have been updated to correct these misclassifications and disclosures as follows:

- The valuation of the investment held in Birmingham Airport had not been received at the date that the draft statement of accounts was submitted to audit. This has since been received and as a result the accounts have been updated for a increase of the carrying amount of £1.873m. The valuation of ordinary shares has increased by £2.015m and preference shares have decreased by £0.142m. This change does not impact on general reserves but does change a number of tables throughout the accounts.

- Capital expenditure met by the council in note 10 for Better Care Fund was mis-stated. The draft accounts were disclosed as £1.986m and have been updated to £2.429m. The change also impacted on other subtotals set out within the note, however it does not change the net deficit on the fund for the year, due to the amount of capital carry forward disclosed of £0.443m been removed. The final change to this note is to allocate the deficit for the year of £0.072m from Walsall CCG to Walsall Council. These changes have no impact on general reserves or elsewhere in the accounts.

- Within note 34 Financial Instruments the interest expense amount disclosed in the income, expense, gains and losses table was misstated as £16.574m. This has been updated to £21.009m. This change had no impact on general reserves or elsewhere in the accounts.

- Within note 13 Exit Packages there was a timing issue identified as to when payments were recognised within this table for 3 employees. This resulted in a restatement of 2014/15 and 2015/16 figures which have been updated. These changes had no impact on general reserves or elsewhere in the statement.

4.3 All of the adjustments listed above have been highlighted in grey on the relevant page of the statement of accounts to ensure changes from the draft statement are clearly visible.

4.4 There were also a small number of other minor changes and disclosures which have not been highlighted within the audit findings report from Ernst & Young. These were all insignificant and had no impact on the level of reserves.

4.5 Management has not adjusted for one audit finding identified by Ernst & Young in relation to the disposal of Oak Park Leisure Centre. The accounts show the old leisure centre being derecognised in 2015/16 when it is actually scheduled for demolition in 2016/17. Management has decided not to adjust the accounts as the de-recognition will occur in the following accounting period (2016/17) and does not materially alter the interpretation of the council's accounts for the reader. The de-recognition represents only 0.44% of the overall property, plant and equipment total.

4.6 In addition to the changes detailed above there are a few control themes and observations made by Ernst & Young. These are laid out in section 3.4 of appendix 1.

5.0 Judgements made within the accounts

5.1 In applying the accounting policies set out within the statement of accounts the council has had to make certain judgements about complex transactions or those involving uncertainty about future events.

5.2 There is a high degree of uncertainty about future levels of funding for local government. However, the council has determined that it does not yet have sufficient detail to provide an indication that its assets might be impaired as a result of a need to close facilities and reduce levels of service provision.

5.3 The council determined that there was no group relationship with Birmingham Airport Holdings Ltd. The basis for this conclusion was that the council had insufficient voting power to affect any decision changes, had no material transactions and did not provide essential technical information. The investments are classified as available for sale financial assets as a recent valuation is available.

5.4 The council has to determine whether the leases that it uses are finance or operating leases. In doing so it utilises five recognition criteria as set out in International Accounting Standard 17 – Leases. These are:

1 the lease transfers ownership of the asset to the lessee by the end of the lease term;
2 the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
3 the lease term is for the major part of the economic life of the asset even if the title is not transferred;
4 at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leases asset; and
5 the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

5.5 If two of these criteria are met then the lease would normally be classified as a finance lease and would therefore become part of the council's balance sheet. All other leases are accounted within revenue. A result of this review is that no new finance leases were identified during 2015/16.

5.6 The council also has to decide whether to apply componentisation for property, plant and equipment. This involved an assessment of each identified component to determine whether it had a significantly different life to other components within the same asset. It was also assessed to determine if the component in question represented a significant element of the whole asset. The council has determined that there are no components to disclose in 2015/16.

5.7 For assets where it is difficult to establish a market value, for instance because they are specialist in nature or are rarely sold, the council utilises a depreciated replacement cost (DRC) based on utilising the latest established “Average Building Prices” information obtained from the Building Cost Information Service (BCIS) website as its baseline data, and applies an inflation rate, obtained from the quarterly BCIS “General Cost Indices”, to reflect change in prices.

6.0 Changes to accounting policies

6.1 As reported to Audit Committee in April 2016 there have been a number of amendments to the councils accounting policies for 2015/16 compared to 2014/15, which are summarised below:

6.2 The policies for Property Plant and Equipment, Investment Properties, Assets Held for Sale and Financial Instruments have been updated for the introduction of the new accounting standard IFRS13 – Fair Value Measurement. This accounting standard introduced the concept and definition of current value for the measurement of property, plant and equipment. This concept requires that local authorities measure the service potential and the operating capacity used to deliver local authority goods and services inherent in the assets. This means that the measurement requirement for operational property, plant and equipment have not changed from those in the 2014/15 Code. However, the Code requires that non-operational property, plant and equipment classified as surplus assets are measured at fair value.

6.3 The policy for Heritage Assets has been amended with the descriptive narrative now only shown within the Heritage Assets disclosure note within the statement of accounts, rather than in both the policy and the disclosure note. This is considered more appropriate and will assist the reader of the accounts to understand the council’s accounting policy more clearly.

6.4 A new policy for Joint Operations has been included to add clarity for the accounting treatment associated with pooled budgets.

6.5 A new policy for Interest in Companies and Other Entities has been included. This policy is included as a result of the spin out of Walsall Adult and Community College (WACC). The Council’s interest in WACC is not considered material and therefore the Council does not intend to produce group accounts on this basis. Further information on the relationship of WACC has been included as a note to the statement of accounts.

6.6 The policy for Private Finance Initiative (PFI) has been amended to add further clarity on the accounting treatment on payments to the operators of PFI schemes.

6.7 There have also been some minor amendments to other accounting policies to ensure they are relevant to the preparation of the Council’s 2015/16 statement of accounts and for minor wording changes to the Code.

7.0 Identifying key trends

7.1 Balance Sheet Performance

Financial indicators are used to identify key trends and highlight the current financial health of the authority. These indicators are also referred to as ratio analysis.

7.2 The position of current assets to current liabilities is an important indicator that effectively identifies the ratio of assets that could quickly be converted to cash in order to cover current liabilities. It is generally accepted that a ratio of 2:1 is the minimum an organisation should seek to achieve, however this can change depending on the sector the business operates in, but this level would normally indicate good cash flow performance and financial health.

7.3 The council's ratio for 2015/16 is 1.77:1, a decrease from 2.45:1 achieved in 2014/15. This reduction is due to using short term investments and cash balances to finance the repayment of a long term loan and associated costs. Direct comparison between authorities is not necessarily an indication of strong or poor performance as councils will have made different decisions regarding their financial strategy, however in comparison to other local authorities within Walsall's statistical neighbour group the level of this ratio is typical.

7.4 Another important ratio in understanding underlying trends in financial health is the comparison between long term assets and long term borrowing. This seeks to highlight the relationship between the borrowing used to purchase the councils property, plant, and equipment, which are then used to deliver the services of the council over a number of years.

7.5 A ratio of 1:1 would be the minimum that would be expected, and would indicate that the council is receiving a benefit from the assets it has purchased that is in line with, or greater than, the repayment of borrowing incurred to fund those assets.

7.6 Walsall's achieved a ratio of 2.29:1 for 2015/16, which is a slight increase from 2.10:1 achieved in 2014/15. This indicates a healthy relationship between long term assets and borrowing, indicating that the council is still receiving the benefit of assets that it has purchased where there is no longer any associated borrowing.

7.7 Plant, property and equipment – note 23

Since the introduction of the Academies Act 2010 the council has seen its asset base reduce by approximately £265m as a result of academy conversions, with these assets therefore no longer owned by the council. The transfer of these schools, along with revaluation losses was potentially making it difficult for readers of the accounts to identify the council investment in other buildings and infrastructure.

7.8 During 2015/16 two schools transferred to academy status as laid out in note 24 to the statement of accounts. The loss of assets through academy transfers since the adoption of the Academies Act in 2010 is one of the reasons that the council's balance sheet is reported as a negative net worth of approximately £118m.

8.0 Looking forward

8.1 The going concern assumption is a fundamental principle in preparing financial statements. Under this principle, Walsall MBC is deemed to be a going concern for the foreseeable future. The statutory duties undertaken by the council and the method in which funding is raised and provided by central Government are set to continue.

8.2 There is no intention to cease trading or seek protection from creditors.

8.3 In addition to this the council has a Medium Term Financial Strategy (MTFS) which is regularly reviewed with the medium term financial outlook updated to reflect the forecast financial position of the council going forward.

9.0 Variance analysis

9.1 There have been a number of material changes to the funding received by the council during 2015/16 which were implemented nationally by central Government.

9.2 Note 19 to the statement of accounts provides an overview of the grant income that the council receives. The major changes seen during 2015/16 were:

- Revenue Support Grant (RSG) £59.978m – decreased again during 2015/16 by approximately £21m as a result of Government spending cuts.

- The council received £21.548m for Better Care Fund during 2015/16. Funding for Adult Personal Social Services reduced from £7.271m in 2014/15 to £0.446m in 2015/16 as this grant was rolled into Better Care Fund.

10.0 Performance management and risk management issues

10.1 The 2015/16 outturn provides a sound, stable financial foundation to affect service delivery and continue to drive service improvement. As part of the council's performance management system, managers are set many targets, one of which is to deliver their service targets within the cash limited budget. This has been demonstrated overall in 2015/16, although some services did overspend, with corrective being taken as appropriate.

10.2 The audit findings report at Appendix 1 has identified minor improvements to the process of producing the annual statement of accounts. It is anticipated that Grant Thornton will address the Committee on the key issues contained in their report.

10.3 <u>Value for Money</u>

Audit Committee is presented with a Value for Money conclusion within the Audit Finding Report (Appendix 1) as it was last year. The result of this report is that Ernst & Young is proposing to issue an unqualified Value for Money conclusion.

11.0 Equality implications

11.1 Improving ease of understanding of the accounts is intended to make the annual statement of accounts more readily accessible to the general public. The accounts will be available on request in different formats, for example, hard copy, soft copy via the web site, Braille and in different languages.

12.0 Consultation

12.1 The report is prepared in consultation with various managers.

13.0 Background Papers

13.1 Various financial working papers, statutory and other guidance.

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