Audit Committee – 24 July 2018

Post – Audit Statement of Accounts 2017/18 including Annual Governance Statement and Audit Findings Report

Summary of report

This report presents the audited Statement of Accounts along with a summary of these, alongside the Annual Governance Statement.

The report also includes Ernst & Young's Audit Findings Report on the authority's accounts, including 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.

Recommendations

Audit Committee are requested to:

1. Receive the audit findings report from Ernst & Young on their audit of the 2017/18 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 1).
3. Note and approve the post-audit statement of accounts for 2017/18 including the Annual Governance Statement (Appendix 2).
4. Note the summary of accounts (Appendix 3).
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 2017/18.

James Walsh
Chief Financial Officer

13 July 2018

Governance

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 (included within the ISA260 report at appendix 1). 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.

Annual Governance Statement

The Annual Governance Statement sits alongside the Statement of Accounts. The draft was received by Audit Committee in June 2018 and the final version, post audit, is attached for consideration and approval.

A report on the annual review of the effectiveness of the system of internal control was submitted to Audit Committee on 18 June, along with the draft Annual Governance Statement for 2017/18. Subsequent to that date, Ofsted has reported on its inspection of New Leaf Pupil Referral Unit. The report was published on 28 June 2018 and determined that the school was inadequate in all areas. The council is currently reviewing the publication and will report on its response once this has been fully considered.

Resource and Legal Considerations

As at 31 March 2018 the post-audit Statement of Accounts shows a net position of an under spend against budget of £0.231 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 £1.322m. This results in net general reserves of £15.226m.

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 adjustments and disclosure amendments. Although none of these have an effect on general fund reserves, the post-audit of Statement of Accounts (Appendix 2) have been updated to correct these misclassifications and disclosures as follows:

Adjusted items:

- The council identified that an amount received in March 2018 for Basic Need Grant had been accounted for as capital grant unapplied. However the grant totalling approximately £9.8m was for 2018/19 and should have been accounted for as a capital grant received in advance. The main effect of the misclassification is that capital grants unapplied is within the bottom half (reserves) of the balance sheet and capital grants received in advance in within the top half of the balance sheet, resulting in a reduction of the net balances.

  These changes have no impact on general reserves, however they do change a number of tables within the Statement of Accounts.

- The audit identified that the total number of exit packages reported in the draft Statement of Accounts was overstated by 1. This was in relation to one member of school based staff whose original dismissal date was subsequently amended by the school, therefore for tax purposes as the original dismissal had already been reported to HM Revenue & Customs a new employment record was created for tax reporting purposes to allow the recording of the dismissal at the revised date. This did only constitute 1 dismissal and as such the note to the accounts has been amended. There is no impact on the reported value of exit packages agreed within the year, and this change has no impact on general reserves.

- The audit identified a number of debtors relating to 'NHS bodies' which had been incorrectly classified within the draft Statement of Accounts as 'other entities and individuals' within note 34. An adjustment has been made to the Statement of Accounts to reclassify these debtors. This change has no impact on the total debtors figure.

- The audit identified a number of financial instrument assets and liabilities that had been incorrectly classified within the draft Statement of Accounts which should not have been classified as financial instruments within note 32. An adjustment has been made to the Statement of Accounts to reclassify these assets and liabilities. This change has no impact on the total figures included within this note.

- The pension fund actuary uses asset values as at 31 December and estimates what the value will be as at 31 March in order to provide timely information for use in the Statement of Accounts. The council's external auditors have identified that the estimated value of Walsall's share of total pension fund assets as at 31 March 2018 used by the actuary in determining the IAS 19 valuation is understated by £27.688m.

  These changes have no impact on general reserves, however they do change a number of tables within the Statement of Accounts.

There were also a small number of other minor changes to 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.

Unadjusted items:

- The audit identified a difference between the figures for property, plant & equipment (PPE) valuations set out within the draft Statement of Accounts and that included within the report from the council's external valuer of £0.865m. Management have determined that as the variance would be equivalent to less than 0.20% of the PPE balance at the year-end making an amendment would not alter the view of a reader of the financial statements and as such have not corrected the differences identified.

- Schools are a specialised asset with no recognisable property market and are valued on a depreciated replacement cost. This method values the school based on the concept of rebuilding the school to modern standards and requirements. In some cases this can result in less land being required than is currently occupied by the current school. This additional school land not included within the valuation is known as site overage. Audit has identified that the PPE net book value was understated by £1.124m due to this site overage. Management have determined that as the variance would be equivalent to less than 0.24% (affected thirty five schools in 2017/18 at an average of £32k per school) of the PPE balance at the year-end making an amendment would not alter the view of the reader of the financial statements and as such have not corrected the differences identified.

Judgements made within the accounts

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.

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.

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.

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.

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. The council recognised one additional finance lease for refuse vehicles during 2017/18.

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 2017/18.

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.

Changes to accounting policies

As reported to Audit Committee in April 2018 there were no amendments to the councils accounting policies for 2017/18 compared to 2016/17.

Identifying key trends

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.

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.

The council's ratio for 2017/18 is 1.03:1, a decrease from 1.86:1 achieved in 2016/17. The reduction in this ratio is a result of the reclassification of loans into short term borrowing from long term borrowing which are due to be repaid in 2018/19 as a result of the upfront pension payment made in April 2017, financed through the use of borrowing from other local authorities. The council would therefore expect this ratio to improve again as this borrowing is repaid over the next 18 months.

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.

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.

Walsall's achieved a ratio of 2.34:1 for 2017/18, an increase from 2.29:1 achieved in 2016/17. 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.

Plant, property and equipment – note 22
Since the introduction of the Academies Act 2010 the council has seen its asset base reduce by approximately £277m 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.

During 2017/18 no further schools transferred to academy status as laid out in note 23 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 £176m.

Looking forward

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.

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

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.

In addition to this the CIPFA Bulleting 01 – Closure of the 2017/18 Financial Statements issued in February 2018 sets out CIPFA's view on going concern as follows:

The provisions in the Code of Practice on the going concern requirements reflect the economic and statutory environment in which local authorities operate. These provisions confirm that, as authorities cannot be created or dissolved without statutory prescription, it would not therefore be appropriate for their financial statements to be prepared on anything other than a going concern basis.

Variance analysis

There have been a number of material changes to the funding received by the council during 2017/18 which were implemented nationally by central Government.

Note 20 to the statement of accounts provides an overview of the grant income that the council receives. The largest change seen during 2017/18 was:

- Revenue Support Grant (RSG) decreased from £45.759m during 2016/17 to nil in 2017/18 as a result of the Council participating in a 100% Business Rates Retention Pilot with the other 6 West Midlands Councils. Further information can be found in the collection fund notes to the accounts.

Performance management and risk management issues

The 2017/18 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 2017/18, although some services did overspend, with corrective being taken as appropriate.

<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.

Equality implications

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.

Consultation

The report is prepared in consultation with various managers.

Background Papers

Various financial working papers, statutory and other guidance.

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