

# Portsmouth City Council

## Governance & Audit & Standards Committee

For the year ended 31 March 2013

Audit results report – ISA 260

26 September 2013



■ Kate Handy, Director  
■ [KHandy@uk.ey.com](mailto:KHandy@uk.ey.com)

■ Mark Justesen, Manager  
■ [MJustesen@uk.ey.com](mailto:MJustesen@uk.ey.com)

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# Executive Summary

## *Key findings*

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### Audit results and other key matters

The Audit Commission's Code of Audit Practice (the Code) requires me to report to 'those charged with governance' on the work I have carried out to discharge my statutory audit responsibilities together with any governance issues identified.

This report summarises the findings from the 2012/13 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

#### **Financial Statements**

- ▶ As of 27 September 2013, I expect to issue an unqualified opinion. My audit demonstrates that the Council has prepared its financial statements well and this is reflected in the low number of issues to bring to your attention.

#### **Value for Money**

- ▶ I expect to conclude that you have made appropriate arrangements to secure economy, efficiency and effectiveness in your use of resources .

#### **Whole of Government Accounts**

- ▶ I expect to issue an unqualified confirmation to the National Audit Office (NAO) regarding the Whole of Government Accounts submission by the 4 October deadline.

#### **Audit Certificate**

- ▶ The audit certificate is issued to demonstrate that the full requirements of the Audit Commission's Code of Audit practice have been discharged for the relevant audit year. I am unable to issue the certificate until I have completed my work on the whole of Government accounts.

# Extent and purpose of our work

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## The Council's responsibilities

The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

## Purpose of our work

My audit was designed to:

- ▶ Express an opinion on the 2012/13 financial statements
- ▶ Report on any exception on the governance statement or other information included in the foreword
- ▶ As a component auditor, follow the group instructions and send to the National Audit Office my group assurance certificate, audit results report and auditor's report on the consolidation schedule
- ▶ Consider and report any matters that prevent me being satisfied that the Council had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the Value for Money conclusion)

This report contains my findings related to the areas of audit emphasis, my views on the Council's accounting policies and judgments and material internal control findings.

This report is intended solely for the information and use of the Council. It is not intended to be and should not be used by anyone other than this specified parties.

# Addressing audit risks

## Significant Audit risks

I identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, I set out how we have gained audit assurance over those issues.

Specific Audit Risks identified within our Audit Plan	Audit Procedures performed	Assurance gained and issues arising
<p>1. Paulsgrove primary school received academy status in January 2013 and the Council is also expecting Milton Cross school to achieve academy status in 12/13.</p>	<ul style="list-style-type: none"> <li>• Our approach focussed on ensuring the transfers, and any related impairments, were accounted for and disclosed correctly.</li> </ul>	<ul style="list-style-type: none"> <li>• Paulsgrove Primary transfer and impairment were correctly accounted for. Milton Cross did not transfer in year.</li> </ul>
<p>2. The Council has expanded its use of pooled budgets to deliver more integrated adult health and social care services.</p>	<ul style="list-style-type: none"> <li>• Our approach focussed on:               <ul style="list-style-type: none"> <li>• Ensuring the Council accurately reflected its share of the income, expenditure, asset and liabilities of the pooled budgets.</li> <li>• Reviewing disclosures to ensure the above is correctly presented in the accounts.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• The pooled budgets were accounted for correctly and values were agreed to the respective M12 pooled finance reports. There were minor disclosure amendments made as a result of the audit.</li> </ul>
<p>3. The Council significantly improved the quality of its accounts and supporting working papers in 11/12. In 12/13 it is reviewing the format of accounts to reduce their size and improve readability.</p>	<ul style="list-style-type: none"> <li>• Our approach focussed on:               <ul style="list-style-type: none"> <li>• Reviewing and monitoring management's closedown processes, in particular quality assurance arrangements, to ensure the accounts and supporting working papers were of an appropriate standard.</li> <li>• Providing a client assistance schedule of expected working papers and discussing progress with management</li> <li>• Reviewing any changes to the accounts format to ensure they comply with disclosure requirements.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Closedown processes appear to have worked successfully. The accounts were of a good standard but followed the format used in previous years. Reasonable quality working papers were prepared, based on our client assistance schedule, and queries were generally turned around promptly - although there were some exceptions to this. There were a number of disclosure adjustments made as a result of the audit.</li> </ul>
<p>4. Management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud. Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.</p>	<ul style="list-style-type: none"> <li>• Based on the requirements of auditing standards our approach focussed on:               <ul style="list-style-type: none"> <li>• Identifying fraud risks during the planning stages.</li> <li>• Inquiry of management about risks of fraud and the controls put in place to address those risks.</li> <li>• Understanding the oversight given by those charged with governance of management's processes.</li> <li>• Consideration of the effectiveness of management's controls designed to address the risk of fraud.</li> <li>• Determining an appropriate strategy to address those identified risks of fraud. This included review of areas where significant judgement is required, such as provisions and review of transactions before and after the year end to ensure they are accounted for in the correct financial period.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• We did not identify a significant fraud risk in our planning, and responses from the Chair of the Governance and Audit and Standards Committee, management and internal audit set out a reasonable control framework.</li> <li>• Our testing strategy focussed on areas with the greatest opportunities for fraud or error: (journal testing, manual debtors and creditors, cut-off) and high levels of judgement (provisions, PFI and valuation of assets). Whilst we identified a number of minor errors, we were able to conclude we have sufficient assurance that the financial statements are free of material misstatements caused by error or fraud.</li> </ul>

# Financial Statements audit

## *Issues and errors arising from the audit*

### Progress of our audit

- ▶ The following areas of my work programme remain to be completed. I will provide an update of progress at the Audit Committee meeting:
  - ▶ Receipt of a Letter of Representation
  - ▶ Some discrete tests within our debtor, creditor, and income and expenditure programme
  - ▶ Supporting evidence for disclosures in the capital commitments note
  - ▶ Whole of government accounts
- ▶ Subject to the satisfactory resolution of the above items, I propose to issue an unqualified audit report on the financial statements.

### Uncorrected Errors

- I have not identified any errors within the draft financial statements that management have chosen not to adjust.
- However, members should be aware testing is ongoing at the time of reporting

### Corrected Errors

■ My audit identified a number of errors that my team highlighted to management for amendment. All of these have been adjusted during the course of our work and in the main related to technical disclosure matters.

■ I do not consider any of these to be significant and therefore I have not provided further details of these amendments.

### Other Matters

■ As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, I am required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process including the following:

- Qualitative aspects of your accounting practices;
- Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions.
- Other audit matters of governance interest

I only wish to highlight to you that the Council needs to prepare Harbour Accounts in companies act format for 2012/13, and then submit them to the Secretary of State once audited.

# Findings and issues

## *Internal Control, Written Representations & Whole of Government Accounts*

### **Internal Control**

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. My responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

I have tested the controls of the Council only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control.

I have reviewed the Annual Governance Statement and can confirm that:

- ▶ it complies with the requirements of CIPFA/SOLACE Delivering Good Governance in Local Government Framework; and
- ▶ it is consistent with other information that I am aware of from my audit of the financial statements.

I have not identified any significant weakness in the design or operation of an internal control that might result in a material error in your financial statements of which you are not aware.

### **Request for written representations**

I have requested a management representation letter to gain management's confirmation in relation to a number of matters, for which I do not currently have sufficient audit evidence. In addition to the standard representations, I have requested the following specific representations:

- ▶ Comparative information
  - ▶ Inclusion of LEP exceptional
- ▶ Use of work of expert
  - ▶ Significance of valuations by Council's valuers

### **Whole of Government Accounts**

Alongside my work on the financial statements, I also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report are specified by the National Audit Office.

I am currently undertaking my work in this area and will report any matters that arise to the Audit Committee.

# Arrangements to secure economy, efficiency and effectiveness

*The Code of Audit Practice (2010) sets out my responsibility to satisfy myself that Portsmouth City Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In examining the Council's corporate performance management and financial management arrangements, I have regard to the following criteria and focus specified by the Audit Commission.*

## Criteria 1 - Arrangements for securing financial resilience

*"Whether the Council has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future"*

➤ I also identified 2 risks in relation to this criteria:

- ▶ The implications of the changes to arrangements for council tax support and business rates in 2013/14
- ▶ Robustness of medium term financial planning in light of the need to identify and deliver significant savings

- ▶ The Council managed its financial performance well during 2012/13; delivering a surplus on the general fund of £0.1m (including schools) that represents a £5.4m improvement on the Council's budget. This has effectively financed part of the capital programme and the planned increase in the Medium Term Resource Strategy Reserve without reducing general fund reserves, giving the Council a sound financial platform as it plans for the impact of the 2013 Comprehensive Spending Review announcement.
- ▶ It has identified savings, efficiencies and additional income of £15m in 2013/14, with a full year effect of £17.5m, but is presently having to review budgets in light of unplanned and increasing demand for children's and adult social services. This demonstrates well the challenge the Council faces over the medium-term, as statutory responsibilities remain unchanged but central funding is reduced.
- ▶ The Council has a clear view of the challenge it faces over the medium term, with budget reductions of £30m needed in 2014/15 to 2016/17. However, there is no documented medium-term financial strategy setting out how it plans to deliver this, and the Council effectively only sets a one year budget aligned to the local election cycle.
- ▶ There are informal arrangements that ensure the Council considers the medium term in setting budgets but I endorse a recent LGA peer review's conclusion that "a longer-term view is essential for the Council to deliver its ambitions, to set smarter targets to plan for financial pressures and the consequences and impact of service changes in one service on another and the city as a whole." As the Council goes through a phase of downsizing, it needs to adopt a strategic approach that gets to a planned end-point rather than implementing incremental and reactive cuts to services.
- ▶ Therefore, while you have arrangements to secure financial resilience for the foreseeable future, you need to take action to secure financial resilience over the medium to longer term.



# Arrangements to secure economy, efficiency and effectiveness

## Criteria 2 - Arrangements for securing economy, efficiency and effectiveness

*“Whether the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.”*

➤ I also identified 4 risks in relation to this criteria:

- ▶ Refresh of the Council’s strategic direction
- ▶ Redevelopment of performance management arrangements
- ▶ Review of risk management arrangements
- ▶ The transfer of public health responsibilities to the Council

- ▶ The Council has been fundamentally reviewing both its corporate priorities and how the business is managed over the last year, and this development process will continue through 2013/14. The Council was keen to develop a bespoke local alternative to a prescriptive regulator-led indicator-led national system but has found this to be a slow and challenging process. We believe the Council’s arrangements suffice to meet the criteria but that this is important developmental work needed to prepare the Council for the changing world it operates in.
- ▶ Defining what makes Portsmouth different from other unitary councils and setting meaningful local development priorities that cascade through business planning processes, has not been straightforward and has involved extensive reflection and discussion. The intention to develop a series of narratives setting out what it means to “work together to shape the great water-front city” is still work in progress, but the work has led to the development of a ‘corporate plan on a page’ that sets a framework for the future transformation of the city and the Council itself. This is an important evolution that needs further development in the run up to the 2014/15 budget-setting process, to ensure there is sufficient clarity and linkage to financial and service planning.
- ▶ The above journey has complicated the development of a new performance management framework. Services were given the license to develop their business plans in their own way, setting out how they would contribute to the ‘great waterfront city’ and what performance indicators should be used to measure their progress. This bottom–up approach has served to flush out a range of cultural issues and concerns that have prolonged the process but allowed a consensus to build around the future approach. Nonetheless it is a priority that the Council define a core suite of indicators that allow it to track how it is delivering against the ‘corporate plan on a page’ and that similar suites are developed that enable proper performance management of services.
- ▶ Corporate risk management processes were considered onerous and had stagnated, so the Council has revisited and refreshed the framework. The design appears appropriate but the operational detail is still being developed and needs to be embedded before 2014/15.
- ▶ The Council has successfully incorporated the public health team and its responsibilities into the wider business, and rationalised its health improvement services in the process. The challenge the Council faces is to balance the achievement of longer-term public health outcomes against the financial climate the Council is operating within. There will be a temptation to seek to incorporate areas of existing Council spend into the grant ring-fence but this must be driven by outcomes and not expedience, as it involves the future health legacy of the population.

# Independence & Audit Fees

## Independence

- ▶ I confirm there are no changes in my assessment of independence since my confirmation in our Audit Plan dated 14 March 2013.
- ▶ I complied with the Ethical Standards for Auditors and the requirements of the Audit Commission's Code and Standing Guidance and in my professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.
- ▶ I confirm that I am not aware of any relationships that may affect the independence and objectivity of the firm that I am required by auditing and ethical standards to report to you.
- ▶ I consider that my independence in this context is a matter that should be reviewed by both you and myself. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning my independence, I will be pleased to do so at the forthcoming meeting of the Governance and Audit and Standards Committee on 26 September 2013.

- ▶ I confirm that I have met the reporting requirements to the Audit Committee, as 'those charged with governance' under International Standards on Auditing (ISA) 260. My communication plan to meet these requirements was set out in the Audit Plan.

## Audit fees

The table below sets out the scale fee and our final proposed audit fees.

	Proposed final fee 2012/13	Scale fee 2012/13	Variation comments
	£s	£s	
Total Audit Fee – Code work	199,980	198,180	Fee increased for elector work. Harbour audit will lead to further fees.
Certification of claims and returns	32,875	26,500	2 new TRA11 claims in 12/13
Non-Audit work	0	0	

- ▶ My actual fee is slightly above the agreed fee, because of work on elector issues, which assumes satisfactory clearance of the outstanding audit work. The grants fee will be higher because of 2 new claims, and the Harbour audit will incur an additional fee.
- ▶ I confirm that I have not undertaken any non-audit work outside of the Audit Commission's Audit Code requirements.

## Ernst & Young LLP

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Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

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In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and audited bodies' (Statement of responsibilities). It is available from the Chief Executive of each audited body and via the [Audit Commission's website](#).

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Audit Results Report is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

