



**Portsmouth City Council
Audit results report**

Year ended 31 March 2017



EY

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XX September 2017

Dear Governance and Audit and Standards Committee Members

We have substantially completed our audit of Portsmouth City Council for the year ended 31 March 2017.

Subject to concluding the outstanding matters listed in our report, we confirm that we expect to issue an unqualified audit opinion on the financial statements in the form at Section 3, before the statutory deadline of 30 September 2017. We also have no matters to report on your arrangements to secure economy, efficiency and effectiveness in your use of resources.

This report is intended solely for the use of the Governance and Audit and Standards Committee, other members of the Council, and senior management. It should not be used for any other purpose or given to any other party without obtaining our written consent.

We would like to thank your staff for their help during the engagement.

We look forward to discussing with you any aspects of this report or any other issues arising from our work.

Yours faithfully

Helen Thompson
Executive Director

For and on behalf of Ernst & Young LLP

United Kingdom

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies". It is available from the via the PSAA website (www.PSAA.co.uk).

The Statement of responsibilities serves as the formal terms of engagement between 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 "Terms of Appointment (updated September 2015)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature..

This report is made solely to the Governance and Audit and Standards Committee, other members of the Council and management of Portsmouth City Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Governance and Audit and Standards Committee, other members of the Council and management of Portsmouth City Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Governance and Audit and Standards Committee, other members of the Council and management of Portsmouth City Council for this report or for the opinions we have formed. It should not be provided to any third-party without obtaining our written consent.



01

Executive Summary



Executive Summary

Overview of the audit

Scope and materiality

In our Audit Plan presented to the Governance and Audit and Standards Committee in February 2017, we gave you an overview of how we intended to carry out our responsibilities as your auditor. We carried out our audit in accordance with this plan.

We planned our procedures using a materiality of £10,769,320. We reassessed this using the actual year-end figures, which has increased this amount to £10,927,360. The threshold for reporting audit differences has increased from £538,466 to £546,368. The basis of our assessment of materiality has remained consistent with prior years at 2% of gross expenditure.

We also identified areas where misstatement at a lower level than materiality might influence the reader and developed specific detailed audit tests for them. They include:

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits.
- ▶ Related party transactions.
- ▶ Members' allowances.

Status of the audit

We have substantially completed our audit of Portsmouth City Council's financial statements for the year ended 31 March 2017 and have performed the procedures outlined in our Audit Plan. Subject to satisfactory completion of the following outstanding items we expect to issue an unqualified opinion on the Council's financial statements in the form which appears at Section 3. However until work is complete, further amendments may arise:

- ▶ Routine testing of property, plant and equipment balances; grant income; and contracts
- ▶ Receipt and review of one bank confirmation letter covering a recorded balance of £5 million
- ▶ Disclosure testing including disclosures in the Movement in Reserves Statement and the Expenditure and Funding Analysis and assessment of disclosures in the Governance Statement and Narrative Statement for consistency with wider audit knowledge
- ▶ Completion of procedures required by the National Audit Office (NAO) regarding the Whole of Government Accounts submission
- ▶ Continued monitoring of progress of EU investigation into transactions with MMD Shipping Services Ltd
- ▶ Manager and director review of outstanding areas of testing
- ▶ Receipt and review of the signed accounts and the signed Letter of Representation
- ▶ Completion of subsequent events review.

We expect to issue the audit certificate at the same time as the audit opinion.



Executive Summary

Executive summary (continued)

Objections

As the Governance and Audit and Standards Committee is aware, we received an objection to the 2015/16 accounts from a member of the public.

After consideration of the evidence provided by the objector and the Council, and review of relevant guidance, we found no evidence to suggest that the Council acted unlawfully in entering into the LOBO arrangement in 2003 and 2007. Therefore, our decision was that there are no items of account related to the LOBOs which are contrary to law. As such, the discretion whether or not to seek a declaration from the court under section 28 of the 2014 Act did not arise and we concluded that we did not need to issue a public interest report. For completeness, although not originally requested in the objection, we concluded that we would not issue an advisory notice as this power does not arise given our conclusions that there is no illegality arising from the LOBOs.

We have not received any objections to the 2016/17 accounts.

Audit differences

At the time of drafting this report, there are no adjusted or unadjusted differences identified from our work that we need to report to you.

We requested some minor changes to disclosure of roundings (all under £10,000).

We note that at the time of writing this report, work is ongoing in a number of areas. We will update the Governance and Audit and Standards Committee of any further adjusted or unadjusted differences.



Executive Summary

Executive summary (continued)

Areas of audit focus

Our Audit Plan identified key areas of focus for our audit of Portsmouth City Council's financial statements. This report sets out our observations and conclusions, including our views on areas which might be conservative, and where there is potential risk and exposure. We summarise our consideration of these matters, and any others identified, in the "Key Audit Issues" section of this report.

We ask you to review these and any other matters in this report to ensure:

- ▶ there are no other considerations or matters that could have an impact on these issues;
- ▶ you agree with the resolution of the issue; and
- ▶ there are no other significant issues to be considered.

There is one matter that we would like to draw to your attention. We engaged our internal specialists to review the detailed models which support the accounting entries for the Highways Maintenance Private Finance Initiative (PFI) Scheme and the Waste Disposal Facilities contract. This work was completed before the Council produced the draft financial statements. As set out in more detail in section 02 of this report, the Council reviewed its estimation methodology based on our findings, including identifying a prior year adjustment to the 2015/16 comparative figures. The Council has clearly identified the impacts of this prior period adjustment in Note 35 of the Annual Report 2016/17. We reviewed the basis of this adjustment and concluded that it was fairly stated.

There are no other matters, apart from those reported by management or disclosed in this report, which we believe should be brought to the attention of the Governance and Audit and Standards Committee.

Value for money

We have considered your arrangements to take informed decisions; deploy resources in a sustainable manner; and work with partners and other third parties. In our Audit Plan we identified the following significant risk: Informed Decision Making.

On completion of our work, we have no matters to report about your arrangements to secure economy efficiency and effectiveness in your use of resources. Our detailed findings are set out in Section 05 of this report.



Executive Summary

Executive summary (continued)

Other reporting issues

Our procedures include reviewing the information presented in the Annual Governance Statement for consistency with our knowledge of the Council. At the time of writing this report, our assessment was ongoing.

We have yet to complete the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission and we will report any issues arising to you when this work is complete.

We have no other matters to report.

Control observations

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements and which is unknown to you.

Independence

Please refer to Appendix B for our update on Independence.





02 Areas of Audit Focus





Areas of Audit Focus

Audit issues and approach – significant risk: Management override

Management override of controls

 Significant Risk

What is the risk?

Risk of management override

As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and to prepare fraudulent financial statements by overriding controls that otherwise seem to be operating effectively.

We identify and respond to this fraud risk on every audit engagement.

What did we do?

We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements.

We reviewed accounting estimates for evidence of management bias and we evaluated the business rationale for any significant unusual transactions.

We performed sample testing on additions to the property, plant and equipment balance.

Our testing of the Movement in Reserves Statement will include assessing the appropriateness of £20,155,000 transferred out of the Earmarked General Fund Reserve and £3,876,000 transferred in to the Housing Revenue Account Earmarked Capital Reserve and of adjustments of £111,221,000 between accounting and funding bases which impact on the Usable and Unusable Reserves.

What are our conclusions?

From our work completed to date:

We have not identified any material weaknesses in controls or evidence of material management override of controls.

We have not identified any instances of inappropriate judgements being applied in relation to your accounting estimates.

We did not identify any other transactions during our audit which appeared unusual or outside the normal course of business.

We found that the additions to property, plant and equipment met the relevant accounting requirements to be capitalised.


We will update our findings when all testing of the Movement in Reserves Statement is complete.



Areas of Audit Focus

Audit issues and approach: Format of comprehensive income and expenditure statement

Format of comprehensive income and expenditure statement

 Other non-significant Risk

What is the risk?

Amendments have been made to the CIPFA Code of Practice on Local Authority Accounting for 2016/17 and it now requires that the service analysis is based on the organisational structure under which the Council operates.

What did we do?

We confirmed that the Comprehensive Income and Expenditure Statement for 2016/17 is compliant with the new requirements.

We confirmed that prior year balances are correctly presented in line with the new requirements

What are our conclusions?

We reviewed the new analysis against requirements of the CIPFA Code in detail. During the exercise to re-analyse line items, the Council identified that in previous years, REFCUS income and expenditure had been netted off against one another instead of being accounted for separately. This mainly affected Solent Enterprise Partnership where gross income and expenditure should have been £34 million higher and to a lesser degree: Children & Education (£1.3million), Health & Social Care (£0.02 million) and Housing (£1.5 million).

This only affected analysis between prior year gross expenditure and prior year gross income. Both were restated this year by £37 million as a prior year adjustment. However, the overall prior year net surplus on the provision of services is unaffected by this change. We tested the prior period adjustment calculations in detail and we were satisfied that the adjustment was correctly calculated and disclosed.


From the work completed we are satisfied that the format of the comprehensive income and expenditure account is appropriate.



Areas of Audit Focus

Audit issues and approach: PFI and similar arrangements

PFI and similar arrangements

 Other non-significant Risk

What is the risk?

Portsmouth City Council has two relatively high value PFI and similar agreements (highways and waste) which have been in place for a number of years. The models were last reviewed in detail by your previous auditor, the Audit Commission. We plan to undertake a number of specific procedures to provide assurance that the accounting models produce materially correct information in the Council's accounts.

What did we do?

We reviewed documentation supporting all four of the Council's PFI (or similar) agreements and confirmed our understanding that it was only the Highways Maintenance PFI Scheme (liabilities of £49.2 million) and Waste Disposal Contract (liabilities of £7.9 million) that were supported by detailed financial models.

We obtained raw data supporting those two models and the EY Financial Accounting Advisory Service team constructed parallel models to test the IFRS and CIPFA Code correctness of payment and liability figures in the draft accounts.

We confirmed that payment schedules in contracts for the two other agreements (Milton Cross School, liabilities £11 million and Learning Disability Facility, liabilities £3.9 million) were sufficiently detailed not to require detailed modelling and we reconciled payments schedules to figures in the draft accounts.



Areas of Audit Focus

Audit issues and approach: PFI and similar arrangements

What are our conclusions?

We noted that the draft accounts presented for audit include a prior period adjustment to correct the methodology used to calculate minimum lease rental payments under the Highways Maintenance agreement. The EY Financial Accounting Advisory team tested the assumptions supporting that adjustment and our audit also included checks on the accuracy of calculations supporting the adjustment. We agreed with the Council's conclusion that liabilities to the highways maintenance contractor had been overstated by £7.1 million and associated assets at 31 March 2016 had been undervalued by £6.1 million.

As part of our work we noted that the Highways Maintenance contract is due to be renegotiated. We will monitor progress on signing deeds of variation until the conclusion of our procedures as these could affect future liabilities payable under that contract. We recommend that the supporting model is revisited by Portsmouth City Council when the deed of variation is signed, with checks to confirm that total liabilities and the classification between operating costs and finance costs under any new contract terms remain in line with the CIPFA Code.

Subject to there being no deeds of variation changes to the Highways Maintenance contract liabilities, payments made and liabilities due under PFI (and similar) agreements have been correctly accounted for and disclosed in the 2016-17 financial statements.



Areas of Audit Focus

Audit issues and approach: EU investigation

EU investigation



Other non-significant Risk

What is the risk?

As noted in our Audit Plan, an EU investigation is currently underway into whether transactions between Portsmouth City Council and MMD (Shipping Services) Ltd have breached state aid regulations.

What did we do?

We reviewed the Council's submission to the European Commission in February 2017; the commissioning of legal searches for evidence supporting that submission; and the value of cash flows between the Council and MMD Shipping Ltd. The evidence reviewed as part of our audit is consistent with the Council's assessment.

Portsmouth City Council assessed that any liability to make payments in connection with the case (fines, for example) is both remote and unquantified. On these grounds a decision was taken by the Council not to include disclosure in the draft accounts or governance statement.

We will continue to monitor for any further developments up until the issue of the audit opinion and certificate.

What are our conclusions?

Evidence reviewed as part of our audit is consistent with Portsmouth City Council's assessment that liabilities in connection with this case are unquantified and remote.

We will continue to monitor for any further developments up until the issue of the audit opinion and certificate.



Areas of Audit Focus

Audit issues and approach: Harbour accounts

Harbour accounts



Other non-significant Risk

What is the risk?

The Department for Transport has indicated that the Council should submit Harbour Accounts for the Commercial Port within nine months of the balance sheet date. To date the Council has not received official communication of the requirement, and therefore has not produced accounts. If the requirement is confirmed, accounts covering the financial years 2012/13 to 2016/17 will need to be prepared and subject to external audit.

What did we do?

We note that The Harbours Act 1964 requires statutory harbour undertakings (a term which includes local authorities that are also harbour authorities) to prepare an annual statement of accounts relating to harbour activities (section 42[1]). The Act expressly states that this requirement is not satisfied by the preparation of a statement of accounts that covers matters in addition to harbour activities (section 42[3]). This means that inclusion of harbour activities within a local authority's general accounts will not satisfy section 42(1) and a standalone annual statement of accounts relating to harbour activities, drawn from the local authority's accounting records, is required.

We monitored management consideration of this issue throughout the audit process.

What are our conclusions?

We confirmed with the Director of Finance and Information Services that, to date, the Council has still not received official communication from the Department for Transport of the requirement to produce accounts, and it therefore has not produced accounts.

We have not received any further clarification from the NAO around our responsibilities as auditor. We will continue to discuss this requirement with officers as part of our 2017/18 audit.



Areas of Audit Focus

Audit issues and approach: Reliance on experts

Reliance on experts

Reliance on experts highlighted in the Audit Plan

We identified three areas in in the financial statements where Portsmouth City Council accounted for valuations derived from the work of experts:

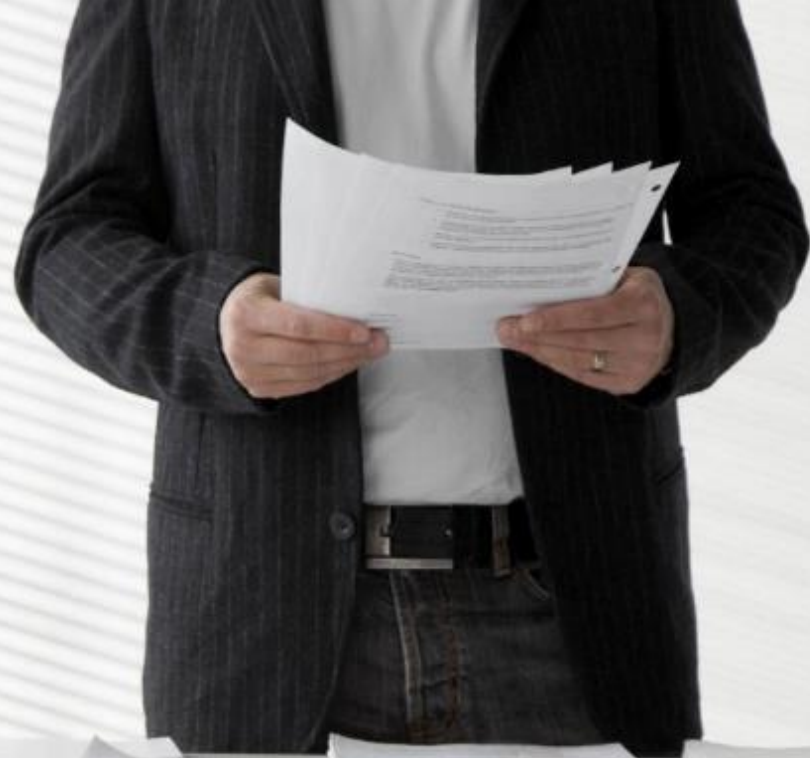
- ▶ Property, plant and equipment (£1,177 million), derived from the work of internal valuers;
- ▶ Pension liability (£355 million), derived from the work of Aon Hewitt; and
- ▶ Provision for appeals by non-domestic rate payers (£7.1 million), derived from the work of Analyse Local.

In accordance with Auditing Standards, our procedures include evaluating each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by each specialist in light of our knowledge of the Council's environment and processes and our assessment of audit risk in the particular area. As part of this work we perform the following procedures:

- ▶ Analyse source data and make inquiries as to the procedures used by the expert to establish whether the source data is relevant and reliable;
- ▶ Assess the reasonableness of the assumptions and methods used;
- ▶ Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

We have no observations to report in connection with this work.



03 Audit Report



Audit Report

Draft audit report

Our opinion on the financial statements

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PORTSMOUTH CITY COUNCIL

Opinion on the Authority's financial statements

We have audited the financial statements of Portsmouth City Council for the year ended 31 March 2017 under the Local Audit and Accountability Act 2014. The financial statements comprise the Movement in Reserves Statement; Comprehensive Income and Expenditure Statement; Balance Sheet; Cash Flow Statement; Expenditure and Funding Analysis on p38 and 39; and Notes 1 to 43 to the financial statements; the Collection Fund and the related notes 1 to 3; and the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the related notes 1 to 5.

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.

This report is made solely to the members of Portsmouth City Council, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Director of Finance & Information Services and auditor

As explained more fully in the Statement of Responsibilities set out on page 34, the Director of Finance & Information Services is responsible for the preparation of the Statement of Accounts 2016/17, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance & Information Services; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Statement of Accounts 2016/17 to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.



Audit Report

Draft audit report (continued)

Our opinion on the financial statements

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of Portsmouth City Council as at 31 March 2017 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.

Opinion on other matters

In our opinion, the information given in the Statement of Accounts 2016/17 for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Council;
- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects.

Conclusion on Portsmouth City Council's arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.



Audit Report

Auditor's responsibilities

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office (NAO) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2016, as to whether Portsmouth City Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether Portsmouth City Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, Portsmouth City Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of our work, having regard to the guidance issued by the Comptroller and Auditor General in November 2016, we are satisfied that, in all significant respects, Portsmouth City Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

Certificate

We certify that we have completed the audit of the accounts of Portsmouth City Council in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice issued by the National Audit Office.

Helen Thompson (senior statutory auditor)
for and on behalf of Ernst & Young LLP, Appointed Auditor
Southampton
September 2017

The maintenance and integrity of the Portsmouth City Council web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



04 Audit Differences



Audit differences

In any audit, we may identify misstatements between amounts we believe should be recorded in the financial statements and disclosures and amounts actually recorded. These differences are classified as 'known' or 'judgemental'. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

Summary of adjusted and unadjusted differences

At the time of drafting this report, there are no adjusted or unadjusted differences identified from our work that require reporting to you.

We requested some minor changes to disclosure of roundings (all under £10,000); the correction of a typing error in a footnote to Note 41; and an enhancement to comparative data in Note 35.

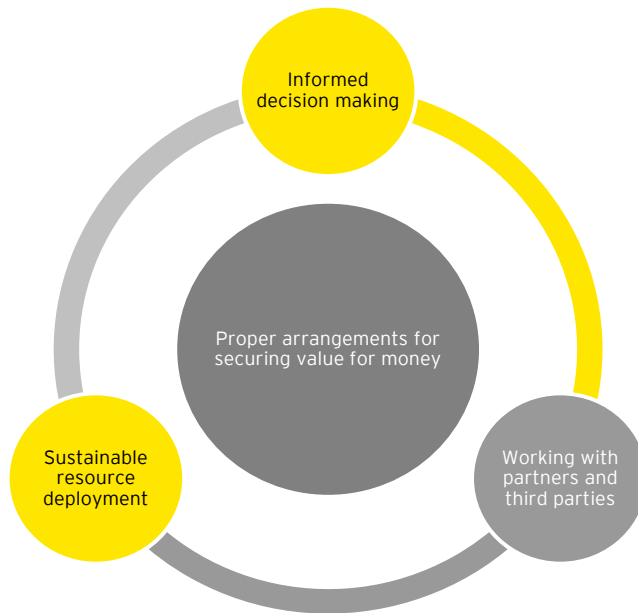
We note that at the time of writing this report, work is ongoing in a number of areas. We will update the Governance and Audit and Standards Committee of any further adjusted or unadjusted differences.



05 Value for Money



Value for Money



Economy, efficiency and effectiveness

We must consider whether you have 'proper arrangements' to secure economy, efficiency and effectiveness in your use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- ▶ take informed decisions;
- ▶ deploy resources in a sustainable manner; and
- ▶ work with partners and other third parties.

In considering your proper arrangements, we use the CIPFA/SOLACE framework for local government to ensure that our assessment is made against an already existing mandatory framework which you use in documents such as your Annual Governance Statement.

Overall conclusion

We identified one significant risk around these arrangements. The table below presents our findings in response to the risk in our Audit Plan. No other risks have been identified since then and there are no other significant weaknesses or issues we want to bring to your attention.

We therefore expect having no matters to report about your arrangements to secure economy, efficiency and effectiveness in your use of resources.



Value for Money

VFM risks

We are only required to determine whether there is any risk that we consider significant within the Code of Audit Practice, where risk is defined as: *“A matter is significant if, in the auditor’s professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public”*

Our risk assessment supports the planning of enough work to deliver a safe conclusion on your arrangements to secure value for money, and enables us to determine the nature and extent of any further work needed. If we do not identify a significant risk we do not need to carry out further work.

The table below presents the findings of our work in response to the risks areas in our Audit Plan [\[as well as any additional risks identified since then\]](#).

What was the significant VFM Risk?

Informed Decision Making

Portsmouth City Council’s strategic priorities are evolving. At the same time, the Council is actively seeking more commercial ways of working, to reduce its’ dependency on central government grants and to help deliver a significant savings plan.

We recognise that risk management processes are already under review by the Council but we note that Portsmouth’s senior management team took on additional responsibilities in relation to two other Councils this year. This could reduce management’s capacity for effective oversight at Portsmouth. We note that for 2015/16, Internal Audit’s Annual Opinion gave limited assurance on internal control and noted that internal control has declined/ not improved in recent years.

There is a risk that as the nature of the Council’s work changes, associated required changes may not be made in a timely fashion to financial and performance information and internal control systems. This could undermine the Council’s ability to demonstrate sound governance and informed decision making.

We note that the strategic and operational changes occurring within Portsmouth City Council are set against a backdrop of changes to the wider environment. These include continued and increasing pressure on the costs of providing children’s and adult social care across the UK and consultations within the Solent area to join three Councils into one Mayoral Authority.



Value for Money

What was our planned response

Obtain and review Portsmouth City Council's newly formatted Corporate Risk Directory. Document and assess the effectiveness of risk escalation procedures.

Document and assess Cabinet and Audit Committee and senior management reporting procedures for capital projects; treasury management; and investment portfolio performance. The timing and quality of data feeding in to reports to Cabinet/ Committee/ senior management will be considered. The mechanisms for Cabinet/ Committee/ senior management discussion and response will also be considered.

Monitor role changes and evolving responsibilities within the senior management team and decision-making by the Corporate Governance Group.

What are our findings?

The Corporate Risk Directory is maintained by the Corporate Performance Manager and updated quarterly using template returns from the directorates. The format of the Register was revised in February 2017 at the request of the Governance and Audit and Standards Committee. The new format aims to present data on performance and major projects and risks for each directorate separately and uses RAG rating to highlight areas of concern. We note that full use of RAG rating has not yet been adopted by every directorate and that the Register does not currently include any data for the Port and for the Property Directorate. However, we also note that the Committee has already flagged these concerns and is already taking steps to expand coverage to all directorates and improve consistency and rigour around use of RAG ratings.

Our testing included assessing in more detail the returns from the Children's Services and Adult Social Care directorates. We were satisfied that appropriate mechanisms were in place for risk escalation.

In most respects, appropriate reporting arrangements are in place and we have concluded that we have no matters to report in relation to the timing, data quality or mechanisms for Council decision making. However, we noted that an Investment Property Strategy was approved by the Cabinet in July 2015, which required that a full report on fund performance be submitted annually to the Cabinet. To date, no such report has been submitted. The Strategy also stipulated that the portfolio mix must be maintained as Core + Core & Opportunities 70 - 80% and Specialist/ residential 20 - 30%. At the time of our visit, we were not able to view data analysed in this way. The only data on portfolio mix that was available was analysed between industrial, retail and other.

As the Council's investment property portfolio expands, it will be important that reporting to Cabinet is monitored closely.

From our review of senior management's changing roles and responsibilities and of the control environment maintained throughout the year, we found no evidence that the control environment has so far been undermined or weakened by the wider roles that the senior leadership team are taking on. As well as the control environment remaining stable, staff satisfaction levels also appear to be reasonable.



What was our planned response

What are our findings?

Track reported service performance levels in performance reports to the Governance and Audit and Standards Committee in Quarters 2 to 4.

Through our attendance at the meetings of the Governance and Audit and Standards Committee, we note that officers have continued to update the quality of the performance information provided by directorates. We reviewed performance data submitted to the Governance and Audit and Standards Committee throughout the year, and we noted the scrutiny given to these issues by Members, and the action taken in response to queries or concerns expressed over performance.. There are no observations arising from our work.

Review Portsmouth City Council's performance against savings plans for 2016-17 and assess the robustness of planned savings for 2017-18 and beyond.

We tested Efficiency Plans, Budget and Council Tax and Savings Proposals from February 2016 to February 2017 and assumptions contained therein. Portsmouth City Council is on track to achieve planned savings of £11 million in 2016/17 and £9 million in 2017/18. In February 2016 the Council had expected further savings of £15 million would be required in 2018/19 and 2019/20. However, by February 2017 the Council assessed that the budget shortfall over that period would be some £7 million lower than had previously been supposed. The Council has a strong track record of achieving planned savings and the reduced target of £8 million for those two years seems achievable. We have assessed the assumptions and planned actions underpinning the identified savings and consider them to be appropriately supported.

However, we note that unfunded capital obligations, many of which are statutory, continue to rise year on year, even after a transfer in 2016/17 of £3.5 million into the capital reserve. Although savings continue to be made by the Council, there seems a likelihood that at some stage there will be a real need to prioritise which planned capital projects will be taken forward.

Compare Internal Audit's 2016-17 programme of work with the risk profile of the organisation and monitor internal audit findings.

We concluded that the Internal Audit programme of work is appropriately risk focused and we have reviewed their findings to inform our own risk assessments. Although Internal Audit has significant, and increasing, commitments to other local authorities, a recruitment programme is in place to expand the team and there is no evidence to date that the core Portsmouth programme of work has been compromised.



06

Other reporting issues



Other reporting issues

Other reporting issues

Consistency of other information published with the financial statements, including the Annual Governance Statement

We must give an opinion on the consistency of the financial and non-financial information in the Statement of Accounts 2016/17 with the audited financial statements.

We must also review the Annual Governance Statement for completeness of disclosures, consistency with other information from our work, and whether it complies with relevant guidance.

This testing was on-going at the time of writing our report.

Whole of Government Accounts

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

We are currently conducting our work in this area and will report any matters arising to the Governance and Audit and Standards Committee.



Other reporting issues

Other reporting issues

Other powers and duties

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Authority to consider it or to bring it to the attention of the public (i.e. "a report in the public interest"). We did not identify any issues which required us to issue a report in the public interest.

We also have a duty to make written recommendations to the Authority, copied to the Secretary of State, and take action in accordance with our responsibilities under the Local Audit and Accountability Act 2014. We did not identify any issues.

Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must tell you significant findings from the audit and other matters if they are significant to your oversight of the Council's financial reporting process. They include the following:

- ▶ Significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures;
- ▶ Any significant difficulties encountered during the audit;
- ▶ Any significant matters arising from the audit that were discussed with management;
- ▶ Written representations we have requested;
- ▶ Expected modifications to the audit report;
- ▶ Any other matters significant to overseeing the financial reporting process;
- ▶ Related parties;
- ▶ External confirmations;
- ▶ Going concern;
- ▶ Consideration of laws and regulations; and
- ▶ Group audits

We have no such matters to report.



07

Assessment of Control Environment



Assessment of Control Environment

Assessment of control environment

Financial controls

It is the responsibility of Portsmouth City 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. Our responsibility as your auditor is to consider whether the Portsmouth City Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Our work to understand the design of internal controls included receiving and reviewing internal audit reports throughout the year. As we have adopted a fully substantive approach, we have not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

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

We note two observations for consideration in future years:

PFI and Similar Arrangements:

As part of our work we noted that the Highways Maintenance contract is due to be renegotiated. We recommend that the supporting model is revisited by Portsmouth City Council when the deed of variation is signed, with checks to confirm that total liabilities and the classification between operating costs and finance costs under any new contract terms remain in line with the CIPFA Code.

Group Accounts:

Portsmouth City Council is the sole owner of MMD Shipping Services Ltd, a company which is growing and for which the Council recently approved future investment of £2 million. On 29 July 2017, the Council also approved an outline business case for the establishment of a municipal energy supply company. Although Portsmouth City Council has so far not met the criteria required by CIPFA for the preparation of group accounts, the criteria should be closely assessed in future years as the size and significance of interests in other entities could increase, meaning that group accounts may be required.



08 Appendices



Appendix A

Required communications with the Governance and Audit and Standards Committee

There are certain communications that we must provide to the Governance and Audit and Standards Committee. We have done this by:

		Our Reporting to you
Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the Governance and Audit and Standards Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, including any limitations.	February 2017 Audit Plan
Significant findings from the audit	<ul style="list-style-type: none"> ▶ Our view of the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Any significant difficulties encountered during the audit ▶ Any significant matters arising from the audit that were discussed with management ▶ Written representations we have requested ▶ Expected modifications to the audit report ▶ Any other matters significant to overseeing the financial reporting process ▶ Findings and issues around the opening balance on initial audits (delete if not an initial audit) 	September 2017 Audit Results Report
Going concern	<p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	No conditions or events were identified, either individually or together to raise any doubt about Portsmouth City Council's ability to continue for the 12 months from the date of our report



Appendix A

		Our Reporting to you
Required communications	What is reported?	When and where
Misstatements	<ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ Significant corrected misstatements, in writing 	September 2017 Audit Results Report
Fraud	<ul style="list-style-type: none"> ▶ Asking the Governance and Audit and Standards Committee whether they have knowledge of any actual, suspected or alleged fraud affecting the Authority ▶ Unless all those charged with governance are involved in managing the entity, any fraud identified or information obtained indicating that a fraud may exist involving: <ul style="list-style-type: none"> (a) management; (b) employees with significant roles in internal control; or (c) others where the fraud results in a material misstatement in the financial statements. ▶ A discussion of any other matters related to fraud, relevant to Governance and Audit and Standards Committee responsibility. 	We have asked management and those charged with governance about arrangements to prevent or detect fraud. We have not become aware of any fraud or illegal acts during our audit
Related parties	<p>Significant matters arising during the audit in connection with the Authority's related parties including, where applicable:</p> <ul style="list-style-type: none"> ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and/or regulations ▶ Difficulty in identifying the party that ultimately controls the entity 	We have no matters to report
Subsequent events	<ul style="list-style-type: none"> ▶ Where appropriate, asking the Governance and Audit and Standards Committee whether any subsequent events have occurred that might affect the financial statements. 	September 2017 Audit Results Report
Other information	<ul style="list-style-type: none"> ▶ Where material inconsistencies are identified in other information included in the document containing the financial statements, but management refuses to make the revision. 	We have no matters to report







Appendix A

Our Reporting to you

Required communications	What is reported?	When and where
External confirmations	<ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ We were unable to obtain relevant and reliable audit evidence from other procedures. 	<p>At the time of writing this report, one bank confirmation letter coveting a recorded balance of £5 million had not yet been received.</p> <p>We have received all other requested confirmations</p>
Consideration of laws and/or regulations	<ul style="list-style-type: none"> ▶ Audit findings of non-compliance where it is material and believed to be intentional. This communication is subject to compliance with legislation on "tipping off" ▶ Asking the Governance and Audit and Standards Committee about possible instances of non-compliance with laws and/or regulations that may have a material effect on the financial statements, and known to the Governance and Audit and Standards Committee. 	<p>We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations</p>
Significant deficiencies in internal controls identified during the audit	<ul style="list-style-type: none"> ▶ Significant deficiencies in internal controls identified during the audit. 	<p>September 2017 Audit Results Report</p>
Independence	<p>Communication of all significant facts and matters that have a bearing on EY's objectivity and independence.</p> <p>Communicating key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information on the firm's general policies and processes for maintaining objectivity and independence <p>Communications whenever significant judgments are made about threats to objectivity or independence and the appropriateness of safeguards,</p>	<p>February 2017 Audit Plan</p> <p>September 2017 Audit Results Report</p>



Appendix A

		 Our Reporting to you
Required communications	 What is reported?	  When and where
Fee Reporting	Breakdown of fee information when the audit plan is agreed Breakdown of fee information at the completion of the audit Any non-audit work	February 2017 Audit Plan September 2017 Audit Results Report
Certification work	Summary of certification work	Certification Report (due later this year)



Independence

We confirm that there are no changes in our assessment of independence since our confirmation in our audit planning board report dated 9 February 2017.

We complied with the APB Ethical Standards and the requirements of the PSAA's Terms of Appointment. In our 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.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your Governance and Audit and Standards Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the Governance and Audit and Standards Committee on 15 September 2017.

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2017.

We confirm that we have not undertaken non-audit work outside the PSAA Code requirements.

	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £	Scale Fee 2015/16 £
Total Audit Fee - Code work	149,438	149,438	149,438	149,438
Objection 2015/16 - additional fee	-	-	TBC	-
Total	149,438	149,438	TBC	149,438
Certification of claims and returns	13,757 ^a	17,196	17,797	17,797

^aIn our April 2017 progress report, we informed you that we have agreed that the Council will perform some of the initial Housing Benefit certification testing itself in 2016/17 in return for a 20% reduction in our fee. We will do sufficient checking to satisfy ourselves that this testing has been performed appropriately before confirming the final fee for this work.



Appendix C

Management representation letter

Management Rep Letter

[To be prepared on the entity's letterhead]

[Date]

Helen Thompson
Ernst & Young
Wessex House
19 Threefield Lane
Southampton
SO14 3QB

This representation letter is provided in connection with your audit of the financial statements of Portsmouth City Council ("the Council") for the year ended 31 March 2017. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the financial statements give a true and fair view of the financial position of Portsmouth City Council as of 31 March 2017 and of its expenditure and income for the year then ended in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016-17.

We understand that the purpose of your audit of our financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK and Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.



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Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

A. Financial Statements and Financial Records

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with the Accounts and Audit Regulations (England) 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016-17.
2. We acknowledge our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of the financial position and of its expenditure and income of the Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016-17 and are free of material misstatements, including omissions. We have approved the financial statements.
3. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.
4. We believe that the Council has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016-17 that are free from material misstatement, whether due to fraud or error.

B. Fraud

1. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud
2. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
3. We have no knowledge of any fraud or suspected fraud involving management or other employees who have a significant role in the Council's internal controls over financial reporting. In addition, we have no knowledge of any fraud or suspected fraud involving other employees in which the fraud could have a material effect on the financial statements. We have no knowledge of any allegations of financial improprieties, including fraud or suspected fraud, (regardless of the source or form and including without limitation, any allegations by "whistleblowers") which could result in a misstatement of the financial statements or otherwise affect the financial reporting of the Council.



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C. Compliance with Laws and Regulations

1. We have disclosed to you all known actual or suspected noncompliance with laws and regulations whose effects should be considered when preparing the financial statements.

D. Information Provided and Completeness of Information and Transactions

1. We have provided you with:
 - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters as agreed in terms of the audit engagement.
 - Additional information that you have requested from us for the purpose of the audit.
 - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence and
 - Appropriate alternative evidence to support entries in the financial statements, where the originals were destroyed in the fire.
2. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
3. We have made available to you all minutes of the meetings of the Council, Cabinet, and Governance & Audit & Standards Committees (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the year to the most recent meeting on the following date: 15 September 2017.
4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Council's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the financial statements.



Appendix C

5. We have disclosed to you, and the Council has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

E. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.
2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We confirm there are no further updates arising from the EU Commission investigation into the allegation that the Council provide state aid to MMD (Shipping Services) Ltd.
4. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent.

F. Subsequent Events

1. There have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

G. Accounting Estimates

1. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.
2. Accounting estimates recognised or disclosed in the financial statements:
 - We believe the measurement processes, including related assumptions and models, we used in determining accounting estimates is appropriate and the application of these processes is consistent.
 - The disclosures relating to accounting estimates are complete and appropriate in accordance with the applicable financial reporting framework.
 - The assumptions we used in making accounting estimates appropriately reflects our intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
 - No subsequent event requires an adjustment to the accounting estimates and disclosures included in the financial statements.



Appendix C

H Retirement benefits

1. On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

I Use of the Work of an Expert

1. We agree with the findings of AON Hewitt engaged to provide IAS19 valuation services for the defined benefit pension scheme as set out in Note 34 and have adequately considered the qualifications of the experts in determining the amounts and disclosures included in the financial statements and the underlying accounting records.
2. We believe the measurement processes employed, including related assumptions and models, in determining accounting estimates is appropriate and consistent with our expectations.
3. We did not give or cause any instructions to be given to the experts with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the experts.

J Expenditure and Funding Analysis

1. We have reviewed the new requirements (as set out in the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17), in relation to the preparation of the Expenditure Funding Analysis to replace the previous segmental reporting analysis, and confirm that all required amendments to the Comprehensive Income and Expenditure Statement and Movement in Reserves Statement, as well as the requirements to prepare the Expenditure Funding Analysis and related notes have been correctly reflected in the financial statements, including retrospectively reflecting this in the financial statements.
2. We confirm that the financial statements reflect the operating segments reported internally to the Council.

Yours Faithfully,

Director of Finance and Information Services



Appendix C

I confirm that this letter has been discussed and agreed at the Governance & Audit & Standards Committee on 15 September 2017

Chairman of Governance & Audit & Standards Committee

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ED None

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