

# Portsmouth City Council

Annual Audit Letter for the year  
ended 31 March 2018

August 2018

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing downwards towards the letters.

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# Contents



Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website ([www.psaa.co.uk](http://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 23 February 2017)' issued by 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 statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter 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.



# 01 Executive Summary



# Executive Summary

We are required to issue an annual audit letter to Portsmouth City Council (the Council) following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's:	Unqualified - the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended.
▶ Financial statements	
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report, other than to confirm the one unadjusted audit difference identified from our audit of the financial statements, in line with NAO instructions. See section 3 for further information on the unadjusted difference.



## Executive Summary (cont'd)

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As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 30 July 2018.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 10 August 2018, following completion of the work necessary to issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack.

In November 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Helen Thompson  
Associate Partner  
For and on behalf of Ernst & Young LLP





## 02 Purpose and Responsibilities

# Purpose and Responsibilities

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## The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the 27 July 2018 Governance & Audit & Standards Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

## Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we presented to the 2 February 2018 Governance & Audit & Standards Committee and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
  - ▶ On the 2017/18 financial statements; and
  - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
  - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - ▶ Any significant matters that are in the public interest;
  - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - ▶ If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

## Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned 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.



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## Financial Statement Audit



## Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health. We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 30 July 2018. Our detailed findings were reported to the 27 July 2018 Governance & Audit & Standards Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Misstatements due to fraud or error	We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements
The financial statements as a whole are not free of material misstatements whether caused by fraud or error.	We reviewed accounting estimates for evidence of management bias We evaluated the business rationale for any significant unusual transactions
As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our work did not identify any: <ul style="list-style-type: none"> <li>• material weaknesses in controls or evidence of material management override.</li> <li>• inappropriate journals or adjustments.</li> <li>• instances of inappropriate judgements being applied in relation to accounting estimates, or other balances and transactions.</li> <li>• other transactions during our audit which appeared unusual or outside the Council's normal course of business.</li> <li>• inappropriate tailoring of accounting policies, or inappropriate changes in policies from the prior year.</li> <li>• instances of inappropriate capitalisation of revenue expenditure.</li> </ul>

## Financial Statement Audit (cont'd)

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The other key areas of focus identified as part of our audit, and related findings, were as follows:

Other Key Findings	Conclusion
<p><b>Valuation of Land and Buildings</b></p> <p>The fair value of Property, Plant and Equipment and Investment Properties represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>	<p>We did not identify any material issues with regard to the valuation of land and buildings.</p>
<p><b>Classification of Investment Properties</b></p> <p>The Local Authority Accounting Code of Practice states that an investment property is one which is held solely to earn rentals or for capital appreciation, or both. Property which is held for any other purpose (even if also earning rentals or achieving capital appreciation) must be classified as property, plant and equipment. It is a requirement that the Council's treatment of property held on its balance sheet conforms to these classifications. Review of assets classified as investment property in 2016/17 identified a number which did not meet the definition and resulted in a significant amendment to the Council's financial statements.</p>	<p>We did not identify any material issues with regard to investment property classification.</p>
<p><b>Private Finance Initiative (PFI) accounting</b></p> <p>The Council has four PFI arrangements, two of which were material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal expert in 2016/17. We reviewed the accounting entries and disclosures in relation to PFI in detail in 2017/18, with a focus on any significant changes since the expert's review in the previous year.</p>	<p>We did not identify any material issues with regard to PFI accounting and no further expert involvement was required.</p>

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## Financial Statement Audit (cont'd)

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The other key areas of focus identified as part of our audit, and related findings, were as follows: (cont'd)

Other Key Findings	Conclusion
<p data-bbox="91 488 470 515">Pension Asset/Liability Valuation</p> <p data-bbox="91 531 1093 647">Accounting for the Local Government Pension Scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p data-bbox="1104 531 2141 647">We did not identify any material issues with regard to the valuation of pension assets and liabilities. We identified one immaterial audit difference, which management chose not to adjust, as a result of comparing the actuarial estimate of the Council's share of pension fund assets against the actual position at 31 March 2018.</p>
<p data-bbox="91 735 275 762">Group Accounts</p> <p data-bbox="91 778 1093 922">IFRS 10, 11 and 12 set out the requirements which must be followed when assessing and disclosing group and joint arrangements. Where the Council has interests in other entities, it needs to undertake qualitative and quantitative assessments to inform its decisions as to whether group accounts are required. This is an area of potential complexity and judgment requiring regular review.</p>	<p data-bbox="1104 778 2141 837">We did not identify any material issues with regard to the Council's group accounts assessment.</p>

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## Financial Statement Audit (cont'd)

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### Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £11.65m (2016/17: £11.01m), which is 2% of gross revenue expenditure reported in the accounts of £582.62m.  We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Governance & Audit & Standards Committee that we would report to the Committee all audit differences in excess of £0.58m (2016/17: £0.55m)

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. We identified one uncorrected judgmental misstatement in relation to pension assets as noted on the previous page. This did not impact our overall opinion on the financial statements.





# 04 Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its 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.



We did not identify any significant risks in relation to these criteria

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We therefore issued an unqualified value for money conclusion on 30 July 2018.





## 05 Other Reporting Issues



## Other Reporting Issues

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### Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report other than to confirm the one unadjusted audit difference identified from our audit of the financial statements, in line with NAO instructions. See section 3 for further information on the unadjusted difference.

### Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

### Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

### Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.



## Other Reporting Issues (cont'd)

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### Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

### Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

### Independence

We communicated our assessment of independence in our Audit Results Report to the Governance & Audit & Standards Committee on 27 July 2018. 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 regulatory and professional requirements.

### Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. 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 identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

Our audit did not identify any controls issues in 2017/18 to bring to the attention of the Governance & Audit & Standards Committee.





# 06 Data Analytics





# Use of Data Analytics in the Audit

## Data analytics – Journals and payroll testing

### Analytics Driven Audit

#### Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- ▶ Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- ▶ Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the Council's audit included testing journal entries and employee expenses, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

#### Journal Entry Analysis

We obtain downloads of all LG financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.

#### Payroll Analysis

We also use our analysers in our payroll testing. We obtain all payroll transactions posted in the year from the payroll system and perform completeness analysis over the data, including reconciling the total amount to the General Ledger trial balance. We then analyse the data against a number of specifically designed procedures. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation.



07 Focused on your future





## Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	<p>Applicable for local authority accounts from the 2018/19 financial year and will change:</p> <ul style="list-style-type: none"> <li>• How financial assets are classified and measured;</li> <li>• How the impairment of financial assets are calculated; and</li> <li>• The disclosure requirements for financial assets.</li> </ul> <p>There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.</p>	<p>Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to:</p> <ul style="list-style-type: none"> <li>• Reclassify existing financial instrument assets</li> <li>• Re-measure and recalculate potential impairments of those assets; and</li> <li>• Prepare additional disclosure notes for material items.</li> </ul>
IFRS 15 Revenue from Contracts with Customers	<p>Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except:</p> <ul style="list-style-type: none"> <li>• Leases;</li> <li>• Financial instruments;</li> <li>• Insurance contracts; and</li> <li>• For local authorities; Council Tax and NDR income.</li> </ul> <p>The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.</p> <p>Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.</p>	<p>As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited.</p> <p>Whilst the standard is not expected to have a material effect, the Council will need to review its existing contracts to ensure it has identified all potential impacts. It will also need to consider the impact on its subsidiary companies, and related group accounts should these be required in future years.</p>



## Focused on your future (cont'd)

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Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>

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A close-up photograph of a person's hand reaching into a filing cabinet to touch a folder. The cabinet is filled with numerous folders of various colors (yellow, blue, white) and sizes, each containing stacks of papers. The background is a textured, light-colored wall.

## 08 Audit Fees

## Audit Fees

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Our fee for 2017/18 is in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA) and reported in our July 2018 Audit Results Report. One minor fee variation is proposed for the Council – details are shown below.

Description	Final Fee 2017/18 £	Planned Fee 2017/18 £	Scale Fee 2017/18 £	Final Fee 2016/17 £
Total Audit Fee – Code work	TBC*	149,438	149,438	149,438
Total Audit Fee – Certification of claims and returns	TBC**	17,797	17,797	17,196

\* We have proposed a scale fee variation of £6,886, in relation to work done in 2017/18 to review in detail the Council's calculation of its minimum revenue provision and related historic overprovision, following its adoption of the annuity method. This work is outside the scope covered by the scale fee. An equivalent fee has not been charged in previous years. The proposed fee variation remains subject to agreement with management and PSAA.

\*\* Our work on the Council's 2017/18 housing benefit subsidy claim is ongoing. Our final fee will be confirmed following the completion of our work. The deadline for certification of the claim is 30 November 2018.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.



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