

# Portsmouth City Council

Annual Audit Letter for the year  
ended 31 March 2019

August 2019

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

Building a better  
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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.psa.co.uk](http://www.psa.co.uk)).

This 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 April 2018)' issued by PSAA set 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 and Terms of Appointment. 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 2019. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2019 and of its expenditure and income for the year then ended.
▶ 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 had put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception: ▶ Consistency of Annual Governance Statement	The Annual 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).	Our work on the Council's Whole of Government Accounts return is scheduled to be completed by 13 September 2019, in line with the national timetable for this work. There are no matters to report at the time of writing this annual audit letter.



## 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 15 July 2019; and we updated our findings at the meeting of the Governance and Audit and Standards Committee on 26 July 2019.
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.	We have not yet issued our audit completion certificate. We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack. We were satisfied that this work did not have a material effect on the financial statements or on our value for money conclusion. We anticipate issuing the certificate on or before 13 September 2019 in line with the timetable for the Whole of Government Accounts as noted previously.

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 2018/19 Audit Results Report to the Governance and Audit and Standards Committee, representing those charged with governance, on 26 July 2019. 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 2018/19 audit work has been undertaken in accordance with the Audit Plan that we issued on 1 February 2019 and was conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
  - ▶ On the 2018/19 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 the 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 (AGS). In the AGS, 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 other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2019.

Our detailed findings were reported to the Governance and Audit and Standards Committee on 26 July 2019.

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

Significant Risk	Conclusion
<p>Misstatements due to fraud or error</p> <p>As identified in ISA (UK) 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.</p>	<p>Our approach was as follows:</p> <ul style="list-style-type: none"><li>• We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements.</li><li>• We reviewed accounting estimates for evidence of management bias.</li><li>• We evaluated the business rationale for any significant unusual transactions.</li></ul> <p>From the work completed, we did not identify:</p> <ul style="list-style-type: none"><li>• Any material weaknesses in controls or evidence of material management override.</li><li>• Any instances of inappropriate judgements being applied.</li><li>• Any other transactions during our audit which appeared unusual or outside the Council's normal course of business.</li></ul>

## Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
<p>Risk of fraud in revenue and expenditure recognition – inappropriate capitalisation of revenue expenditure</p> <p>Under ISA (UK) 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>We assessed that the risk is most likely to occur through the inappropriate capitalisation of revenue expenditure, leading to overstatement of Property, Plant and Equipment (PPE) and/or Investment Property (IP) in the Balance Sheet, and understatement of expenditure in the Comprehensive Income and Expenditure Statement.</p> <p>The value of PPE additions in 2018/19 was £108m and the value of IP additions was £29m.</p>	<p>Our audit work was as follows:</p> <ul style="list-style-type: none"> <li>• We tested PPE/IP additions, using lowered testing thresholds, to ensure they were appropriately supported by documentary evidence, and that the expenditure incurred and capitalised was clearly capital in nature.</li> <li>• When performing journals testing, we challenged the basis for any significant journals transferring expenditure from non-capital codes to PPE/IP additions or from revenue to capital codes on the general ledger at the end of the year.</li> </ul> <p>We did not identify any instances of inappropriate capitalisation of revenue expenditure.</p>

Other areas of audit focus	Conclusion
<p>Valuation of Land and Buildings, and Investment Property</p> <p>The fair value of Property, Plant and Equipment (PPE) and Investment Property (IP) 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>ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p> <p>The net book value of PPE at 31/03/2019 was £1.27bn, and the value of IP was £182m.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> <li>• The adequacy of the scope of the work performed by the Council's expert valuers including their professional capabilities.</li> <li>• The reasonableness of the underlying assumptions used by the valuers.</li> <li>• The material correctness of the carrying value of assets not revalued in 2018/19.</li> </ul> <p>We identified one misstatement above our reporting threshold, arising because the fixed asset register had not been fully updated for all valuations undertaken in 2018/19. This was corrected by management in the final version of the financial statements.</p> <p>We did not identify any issues with regard to the carrying value of assets not revalued in 2018/19.</p>

## Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other areas of audit focus	Conclusion
<p>Private Finance Initiative (PFI) Accounting</p> <p>The Council has four PFI arrangements, two of which are material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal specialist in 2016/17. We reviewed the accounting entries and disclosures in relation to PFI in detail in 2018/19, with a focus on any significant changes since the specialist's review in 2016/17.</p> <p>The total finance lease liability for PFIs was £65m at 31/03/2019, and the value of PFI assets was £131m.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> <li>• Reviewing assurances brought forward from prior years regarding the appropriateness of the PFI financial models.</li> <li>• Reviewing the PFI financial models for any significant changes.</li> <li>• Ensuring the PFI accounting models had been updated for any service or other agreed variations and confirming consistency of current year models with prior year brought forward assurances.</li> <li>• Agreeing outputs of the models to the accounts, including balances and disclosures for Assets, Liabilities, and Expenditure, and reviewing the completeness and accuracy of disclosures.</li> </ul> <p>We did not identify any issues with regard to PFI accounting through performance of the above programme of work.</p>
<p>Pension Liability Valuation</p> <p>The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p> <p>The net pension liability at 31/03/2019 was £365m.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> <li>• The reasonableness of the underlying assumptions used by the Council's expert – Aon Hewitt.</li> <li>• Ensuring the information supplied to the actuary in relation to Portsmouth City Council was complete and accurate.</li> <li>• Ensuring the accounting entries and disclosures made in the financial statements were consistent with the report from Aon Hewitt.</li> </ul> <p>We did not identify any material issues with regard to the valuation of the pension liability. We identified one immaterial audit difference, which management chose not to adjust, as a result of reviewing the assumptions made by the actuary, specifically with regard to Guaranteed Minimum Pension (GMP).</p>

## Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other areas of audit focus	Conclusion
<p>Minimum Revenue Provision (MRP)</p> <p>Local authorities are normally required each year to set aside some of their revenues as provision for capital expenditure financed by borrowing or credit arrangements. This provision is known as MRP. MRP is a real charge that impacts on the general fund and therefore the council tax financing requirement. The Council has amended its method for calculating MRP, using an annuity approach, which has resulted in reduced MRP charges in the short term and the calculation of a historic over-provision of MRP. The calculation of MRP is inherently complex and as such we have used an internal specialist to assist with our review of the Council's revised MRP calculations.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> <li>• Considering the outputs of the review by our internal specialist of the Council's MRP calculations commenced in 2017/18; and</li> <li>• Using this to inform our assessment of the material accuracy of the Council's MRP estimate and historic overprovision</li> </ul> <p>Our internal specialist undertook a detailed review of the Council's revised MRP calculations and historic overprovision. Following some agreed revisions to the underlying calculations, we obtained assurance over the material accuracy of the historic overprovision. No issues were identified with the net MRP charges in the Council's financial statements since the amended approach to MRP was applied.</p>
<p>New Accounting Standards</p> <p>IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) applied from 1 April 2018.</p> <p>IFRS 9 changed:</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 instruments.</li> </ul> <p>The key requirements of IFRS 15 cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The impact on local authority accounting is generally limited as large revenue streams like council tax, non domestic rates and government grants are outside the scope of IFRS 15.</p>	<p>Our work focussed on:</p> <ul style="list-style-type: none"> <li>• Assessing the Council's implementation arrangements and accounting for the new standards in 2018/19.</li> </ul> <p>The Council was able to demonstrate that implementation of IFRS 15 had no material impact on its financial reporting arrangements.</p> <p>For IFRS 9 we concluded that:</p> <ul style="list-style-type: none"> <li>• Required changes to the classification and accounting for financial instruments were made correctly.</li> <li>• Any changes to impairments and provisions for financial assets were immaterial to the accounts.</li> <li>• CIPFA Code disclosure requirements were met.</li> </ul>

## 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	<p>We determined planning materiality to be £10.64m (2017/18: £11.65m), which is 1.8% (2017/18 2%) of gross revenue expenditure reported in the accounts of £591.3 million (excluding one accounting entry considered exceptional, but which had no impact on the General Fund or Council taxpayer).</p> <p>We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Governance and Audit and Standards Committee that we would report to the Committee all audit differences in excess of £0.53m (2017/18: £0.58m) .</p>

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied included:

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits: these areas were tested in detail as part of our audit.
- ▶ Related party transactions: these were tested in detail as part of our audit.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. No issues which were considered to warrant reporting to those charged with governance were identified in the above areas.



# 04 Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in 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 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 31 July 2019.



## 05 Other Reporting Issues



## Other Reporting Issues

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### Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

Our work on the Council's Whole of Government Accounts return is scheduled to be completed by 13 September 2019, in line with the national timetable for this work. There are no matters to report at the time of writing this annual audit letter.

### 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 2018/19 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 and Audit and Standards Committee on 26 July 2019. 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 audit approach and have therefore not tested the operation of controls.

Our audit did not identify any controls issues to bring to the attention of the Governance and Audit and Standards Committee.



06

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 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 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 2020/21 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 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, it is clear 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>
IASB Conceptual Framework	<p>The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>This introduces;</p> <ul style="list-style-type: none"> <li>- new definitions of assets, liabilities, income and expenses</li> <li>- updates for the inclusion of the recognition process and criteria and new provisions on derecognition</li> <li>- enhanced guidance on accounting measurement bases</li> <li>- enhanced objectives for financial reporting and the qualitative aspects of financial information.</li> </ul> <p>The conceptual frameworks is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards.</p> <p>However, an understanding of concepts and principles can be helpful to preparers of local authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.</p>	<p>It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements.</p> <p>However, authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.</p>

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.

## 07 Audit Fees

## Audit Fees

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Our planned fee for 2018/19 is in line with the scale fee set by the PSAA and reported in our 15 July 2019 Audit Results Report. Our final fee remains subject to agreement with management and PSAA.

Description	Proposed Final Fee 2018/19 £	Planned Fee 2018/19 £	Scale Fee 2018/19 £	Final Fee 2017/18 £
Total Audit Fee – Code work	115,449*	115,067	115,067	156,324

\* See below for explanation:

As we are no longer the reporting accountant for the Council's housing benefit subsidy claim, we needed to undertake work as part of the financial statements audit which we would previously have performed as part of certifying the housing benefit claim and used for both engagements. This work would previously have been covered by the fee for the housing benefit certification. As such, we are proposing an additional fee of £382 for this work.

The proposed additional fee remains subject to agreement with management and PSAA.

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