Eastern Shires Purchasing Organisation

Report to those charged with governance

Report to the Management Committee of Eastern Shires Purchasing Organisation (ESPO) on the audit for the year ended 31 March 2019 *(ISA (UK) 260)*

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Government and Public Sector

September 2019

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Contents

An audit of the Statement of Accounts is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.

This report contains a summary of the results of our audit and matters which we ask the Management Committee to consider.

Executive summary

Background

This report tells you about the significant findings from our audit. We presented our plan to you in June 2019; we have reviewed the plan and concluded that it remains appropriate. Details of our Audit Approach are included in the following section of this report.

An audit of the Statement of Accounts is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.

Audit Summary

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the non-statutory Statement of Accounts following their approval by the Management Committee on 19 September 2019.

The key outstanding matters, where our work has commenced but is not yet finalised, are:

- completion of our going concern review;
- completion of our review of the Director's report;
- completion of our documentation, internal review and quality control procedures;
- completion procedures including subsequent events review;
- approval of the Statement of Accounts and letter of representation by the Management Committee; and
- receipt of the final signed Statement of Accounts and the management representation letter.

There are key judgements which require the Management Committee's attention – further details are set out commencing on pages 6 to 11.

The following additional reports have been issued to those charged with governance in 2018/19:

- External Audit Plan 2018/19 – presented to Management Committee in June 2019.

We have remained committed to providing you with a high quality service as we have audited your non-statutory accounts this year. We thank the Finance Team and others for their support and assistance during the course of our work and look forward to discussing our report with you on 19 September 2019.

The scorecard below summarises our view of your accounts and audit performance:

Key

● **Red** – significant improvements required
● **Amber** – some minor improvements required
● Green – no / minimal improvements required

Area	Rating	Comments
Draft accounts	● Green	Your draft accounts were submitted to us in July and were of a good quality. As we would expect in any audit, we identified a small number of disclosure issues which ESPO agreed to amend within the financial statements; none of these disclosure issues were significant.
Readiness for start of audit and working papers	● Green	Working papers were ready for us at the start of the audit, provided electronically and in paper format, to enable us to select samples without delay. This helped the efficiency and smooth running of the audit, and allowed us to make a prompt and efficient start to our work on the first day we arrived on site. Supporting working papers were of a consistently good standard.
Availability and responsiveness of staff	● Green	The finance team and key members of staff were easily accessible to us during the audit and responded promptly to our audit questions and requests for information.
Significant audit and accounting issues	● Green	We identified some audit and accounting issues during the audit which are explained later in this report. We are satisfied that these are appropriately reflected and disclosed in the financial statements and will be giving an unqualified opinion on the 2018/19 financial statements.
Deficiencies in internal control systems	● **Amber**	We have not identified any significant or material deficiencies in internal control, but have identified some matters to bring to your attention later in this report.

Audit approach

The following pages highlight the risks we originally identified in our Audit Plan, and explain what we have done in response.

The risks presented here, Management Override of Controls and the Recognition of Income and Expenditure, are presumed to be significant risks under International Standards on Auditing.

Our audit approach was set in our audit plan which we presented to you in June 2019.

We have summarised below the significant risks we identified in our audit plan relating to the audit of ESPO's financial statements, the audit approach we took to address each risk and the outcome of our work.

Risk	Audit approach and results of work performed
Management override of controls (Significant Risk) ISA (UK) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. In any organisation, management may be in a position to override the financial controls that are in place. A control breach of this nature may result in a material misstatement. For all of our audits, we are required to consider this as a significant risk and adapt our audit procedures accordingly. In your organisation, as the pressure to deliver a surplus increases, so does the risk of management override.	We understood and considered your internal control processes and reviewed the work of Internal Audit to consider the issues they raised and the level of assurance that they provided regarding management's ability to override controls. We performed the following procedures: • reviewed the appropriateness of accounting policies and estimation bases, focusing on any changes not driven by amendments to reporting standards; • sample tested the appropriateness of journal entries posted during the year on a risk basis; • reviewed accounting estimates for bias and evaluated whether circumstances producing any bias represent a risk of material misstatement due to fraud; • evaluated the business rationale underlying significant transactions; • independently confirmed ESPO's bank accounts and tested the bank and other key control account reconciliations; and • included an element of 'unpredictability' in our testing, including employing the use of our HALO software to test journal transactions in ESPO's general ledger. **We did not identify any issues to report.**

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Risk	Audit approach and results of work performed
Risk of fraud in revenue and expenditure recognition (Significant Risk) Under ISA (UK) 240 there is a presumption that there are risks of fraud in revenue recognition. We extend this presumption to the recognition of expenditure in local government. There is a risk that ESPO could adopt accounting policies or treat income and expenditure transactions in such a way as to lead to material misstatement in the reported revenue position.	We understood and considered your internal processes around relevant income and expenditure controls, and reviewed the outcomes of Internal Audit work to establish whether these are operating effectively. Our final audit procedures included: • testing the appropriateness of journals processed during the year; • evaluating accounting policies for income and expenditure recognition to ensure these are consistent with the requirements of the Code of Practice on Local Authority Accounting; • reviewing significant accounting estimates and judgements for indicators of management bias; • testing revenue and expenditure cut off at year end; • understanding how rebate income from suppliers is recognised, and testing this on a sample basis; • testing a sample of income and expenditure transactions, including accruals; and • performing analytical procedures on income and expenditure at the year-end. **We did not identify any significant issues to report.**

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Intelligent scoping

In our audit plan presented to you in June 2019 we reported our planned overall materiality which we used in planning the overall audit strategy. Our materiality thresholds were updated on receipt of the draft 2018/19 financial statements.

Our revised materiality levels are as follows:

	Original Plan £000	Revised £000
Overall materiality	1,590	1,728
Clearly trivial reporting de minimis	79	86

Overall materiality has been set at 2% of actual revenue for the year ended 31 March 2019.

ISA (UK) 450 (revised) requires that we record all misstatements identified except those which are “clearly trivial” i.e. those which we do expect not to have a material effect on the financial statements even if accumulated. We agreed the de minimis threshold with the Management Committee at its meeting in June 2019.

Significant audit and accounting matters

There are no material accounting issues to draw to your attention.

However, we have highlighted on the next few pages some of the key issues we have identified in our audit for you to consider.

The level of your reserves continues to be strong. This includes your General Fund and your Earmarked Reserves, which are held for specific future purposes.

We did not identify any accounting adjustments during the audit.

Auditing Standards require us to tell you about relevant matters relating to the audit of the Statement of Accounts sufficiently promptly to enable you to take appropriate action.

Accounts

We have completed our audit, subject to the following outstanding matters:

- completion of our going concern review;
- completion of our review of the narrative report;
- completion of our documentation, internal review and quality control procedures;
- completion procedures including subsequent events review;
- approval of the Statement of Accounts and letter of representation by the Management Committee; and
- receipt of the final signed Statement of Accounts and the management representation letter.

Subject to the satisfactory resolution of these matters we expect to issue an unqualified audit opinion.

Accounting issues

We identified no material accounting issues, but we would like to draw to your attention the following matters resulting from our work to assist you in fulfilling your governance responsibilities:

Rebate (Framework Use Commission) revenue recognition

We have discussed with management and consider the revenue recognition policy to be appropriate but management should consider whether this income should be referred to as a ‘rebate’. As there is no purchase by ESPO and the income relates to framework agreements, it is more in the nature of commission rather than rebates.

Many of ESPO's contracts with suppliers contain retrospective rebate agreements. Under the terms of these agreements, ESPO is paid back an agreed percentage of the total spend over an agreed period by the supplier. Rebates are always paid at the end of the contract period, which can vary from a few months to a year, and may span more than one financial period. Suppliers notify ESPO of the total income over the period and the resulting rebate to ESPO. ESPO then raises a sales invoice to the supplier for the amount of income due.

In 2018/19, rebate income recognised within the financial statements is approximately £7.4m compared to £6.61m in the previous year. This is relatively consistent with the increase in the previous year when around £6.03m was recognised in 2016/17.

ESPO monitors total spend with each supplier on a monthly basis. At the end of the contract period, the amount of rebate owed to ESPO is calculated based on the percentage outlined in the contract. The supplier pays the rebate once it receives the sales invoice raised by ESPO.

We found no exceptions from our income sample tested.

At year end, the rebate is recognised as a debtor because an invoice has been raised to the supplier based on the amount of rebate due to ESPO. The cash is accounted for in the period in which it is received.

Each year, some cash is received after ESPO closes its accounts, meaning it is recorded in the following financial year. This approach is consistent with that applied in previous years. Management estimate that approximately £245,000 – £250,000 of rebate income is recorded in the following year because it is received after the accounts were closed. Management confirmed that as these amounts are consistent from year to year, the overall impact on ESPO's surplus on a yearly basis is unlikely to be material.

The Statement of Accounts disclose the accounting policy for rebate income as follows: “Rebates are recognised where they can be reliably measured and agreed with the supplier and are retrospective. Cash is accounted for in the period it is received.

We have no further matters that we wish to draw to your attention.

Direct sales cut-off

Consistent with prior year, some of the goods that ESPO sells to customers are through direct sales, rather than being from the warehouse inventory. Under these arrangements, the customer orders directly from the supplier and the goods are delivered directly to the customer.

ESPO receives the sales invoice from the supplier, and subsequently raises a sales invoice to the customer. It is upon receiving the invoice that ESPO is made aware of the order, so it is difficult to know what has been ordered directly from suppliers around year end.

This year, our expenditure sample testing did not identify any cut-off errors; however we are aware that these exist every year. Because ESPO does not receive confirmation from its customers at year end of how much has been ordered, no accrual is made for these transactions. We discussed this with management again this year, and acknowledge that it would be very costly and resource-intensive to request confirmations from each customer.

This is a cyclical process and the impact on ESPO's accounts is unlikely to be material because it is a small percentage of the annual income and expenditure that is ordered around year end. *The approach adopted this year is consistent with previous years and no further exceptions have been noted to bring to your attention on this matter.*

We also ask you to confirm in the letter of representation that you are satisfied with the appropriateness of accounting for the above three arrangements on a cash, rather than an accruals, basis.

Pensions

There are two legal matters that are currently affecting the local government pension scheme.

- GMP Equalisation and Indexation; and
- McCloud Judgement (age discrimination).

GMP Equalisation and Indexation

There are two parts to the impact of the GMP Equalisation and Indexation developments, those who reach state pension age (SPA) between 2016 – 2021 and those post 2021. The actuary has estimated the maximum allowance of this would be up to 0.5% of liability and have made no allowance in the current calculation for this impact on the grounds of materiality.

PwC's actuarial team have concluded that the approach is reasonable and the impact (depending on the individual scheme profile) would be 0.1% of liability for those reaching SPA 2016 – 2021 and post 2021 the impact at 0.2% of liability. This is therefore consistent with the conclusions and approach of the scheme actuary and the monetary impact would be £74,000 based on PwC actuarial assessment and a maximum of £124,000 based on the scheme actuary.

We agree with management and the scheme actuary that on the grounds of materiality no adjustment should be made for this in the 2018/19 financial statements. This will also be included in our letter of representation.

McCloud Judgement

There have been two legal rulings that found that transitional schemes where members were transferred to new schemes and were age discriminatory on the grounds not objectively assessed (cases involving judges and firefighters) and has similar implications for other public sector schemes including the LGPS.

The actuary has estimated this in the 2018/19 numbers and this resulted in an additional £0.66m of past service costs and an increase in net liability to £24.8m from the initial draft numbers provided. These have been appropriately reflected in the 2018/19 financial statements.

We agree with management and the scheme actuary that this should be reflected in the 2018/19 numbers. This will also be included in our letter of representation.

Valuations

ESPO undertook a valuation of its warehouse for the 2018/19 financial statements by the LCC valuer and this has resulted in a valuation of £13.3m, an increase of £0.744m.

We have used our valuations team to review the assumptions and methodology and have concluded that the valuation is consistent with previous years and the assumptions are reasonable when compared to other national / regional benchmarks for industrial property (see also our estimates section later in this report). *We have no issues to report in relation to the valuation or accounting in the 2018/19 financial statements.*

Underlying data used for the warehouse valuation
We noted that the areas used by the valuer in the report had increased slightly compared to prior year and discussed with management whether there had been any changes / additions to the warehouse that would result in an increased area and no such changes were identified.

We were advised that this was due to the latest RICS guidance/methodology, we then subsequently assessed the impact, based on the movement from our prior year report and the attached plans and internal areas of the 2019 valuation. The financial impact was estimated at £80k, which is below our reporting level and therefore concluded no further action / investigation was required where no change was expected.

We have raised a control observation (see section on page 13) ensuring as part of the annual valuation where base data numbers have changed or not consistent with the underlying plans or prior year valuation report that the valuer should include an explicit reason why the areas have changed (if no change to warehouse configuration or additions) and whether the plans have been formally updated or not.

Misstatements and significant audit adjustments

We have to tell you about all uncorrected misstatements we found during the audit, other than those which are trivial. We are also required to report to you material amendments made to your draft accounts as a result of the audit.

We are pleased to report that our work there are no uncorrected misstatements to your draft accounts. We have discussed a limited number of adjustments noted during the audit with management at our clearance meeting on 5 September 2019, however all are below our clearly trivial level and not considered significant to raise with the committee.

Significant accounting principles and policies

Significant accounting principles and policies are disclosed in the notes to the Statement of Accounts. We will ask management to represent to us that the selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the Statement of Accounts have been considered. Please refer to the management representation letter.

Judgements and accounting estimates

ESPO is not required to prepare its financial statements in accordance with the CIPFA Code under a statutory obligation, but has chosen to continue to do so in 2018/19. This is consistent with the approach in 2017/18. Nevertheless, there are still many areas where management need to apply judgement to the recognition and measurement of items in the financial statements. The following significant judgements and accounting estimates were used in the preparation of the financial statements:

Valuation of non-current assets
The valuation of non-current assets is an area of significant judgement within the accounts. You have used an independent valuer from Leicestershire County Council to revalue your main office and warehouse building as at 31 March 2019. This resulted in a valuation gain of £0.644m to £13.3m. We have used our specialist valuation team to review the assumptions

used by the valuer who assessed these assumptions against property valuations data. Our specialist valuation team assessed the increase in capital value to be at the top end of the reasonable range when comparing against the index for industrial properties for the rest of the UK. Nevertheless, we have confirmed your approach is reasonable and consistent with prior year.

Pensions

The most significant judgements relate to the pension liability assumptions. We are satisfied that the actuarial assumptions used for the Local Government Pension Scheme by Hymens Robertson are overall reasonable is consistent year on year with the actuaries assessment and therefore no indication of specific bias in the current financial year .

	ESPO Assumption
Discount rate	2.4%
CPI inflation rate Rate of pension increase	2.5% 2.5%
Rate of salary increase	3.5%
Life Expectancy in years at age 65 (Pensioners) (M, F)	22.10 24.30
Life Expectancy in years at age 45 (non-pensioners) (M, F)	23.80 26.20

We do not consider the assumptions and estimates applied by the actuary and ESPO for the purposes of the financial statements to be unreasonable.

Accruals

Accruals for expenditure and income are raised where an invoice has not been received or raised at the year-end, but ESPO knows that there is a liability to be met which relates to the current year. This involves a degree of estimation. Detailed testing was performed on significant accruals. *No misstatements were identified from this work.*

Bad Debt Provision

There is an inherent level of judgement involved in calculating your bad debt provision, which is done by assessing the potential recoverability of invoices which are beyond the due date for payment. As at 31 March 2019, the bad debt provision has been calculated at £91k (compared to £77k as at 31 March 2018). We have considered the recoverability of debtors and have not identified any significant concerns in the way that you have calculated your bad debt provision.

We ask management to send us a letter of representation before we sign our audit opinion.

We are required to demonstrate our independence by professional standards. Maintaining our independence is important to us in delivering you a robust external audit.

We have concluded that we are independent and comply with the relevant UK regulatory and professional requirements.

Overall we found your significant judgements and accounting estimates to be reasonable.

Management representations

The draft of the representation letter that we ask management to sign is attached as a separate letter to this report.

Financial standing

You identified no material uncertainties related to events and conditions that may cast significant doubt on the ESPO's ability to continue as a going concern and that in overall terms there are sufficient resources available to meet your commitments for at least a 12-month period after the projected date of our audit opinion. We have initially concluded that this consideration is appropriate, but are finalising our detailed review and considerations.

Related parties

In forming an opinion on the financial statements, we are required to evaluate:

- whether identified related party relationships and transactions have been appropriately accounted for and disclosed; and
- whether the effects of the related party relationships and transactions cause the financial statements to be misleading.

To confirm completeness we performed a range of additional procedures to identify potential related party transactions and did not identify matters during the course of our work.

Audit independence

We are required to follow both the International Standard on Auditing (UK and Ireland) 260 (Revised) "Communication with those charged with governance", UK Ethical Standard 1 (Revised) "Integrity, objectivity and independence" and UK Ethical Standard 5 (Revised) "Non-audit services provided to audited entities" issued by the UK Auditing Practices Board.

Together these require that we tell you at least annually about all relationships between PricewaterhouseCoopers LLP in the UK and other PricewaterhouseCoopers' firms and associated entities ("PwC") and the Authority that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity.

Relationships between PwC and the Committee

We are aware of the following relationships that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity and which represent matters that have occurred during the financial year on which we are to report or up to the date of this document.

Relationships and Investments

We have not identified any potential issues in respect of personal relationships with the Committee or investments in the Committee held by individuals.

Employment of PricewaterhouseCoopers staff by the Committee

We are not aware of any former PwC partners or staff being employed, or holding discussions in respect of employment, by the Committee as a director or in a senior management position covering financial, accounting or control related areas.

Business relationships

We have not identified any business relationships between PwC and the Committee.

Services provided to the Committee

The audit of the Statement of Accounts is undertaken in accordance with the UK Firm's internal policies. The audit is also subject to other internal PwC quality control procedures such as peer reviews by other offices. We have not undertaken any non-audit services at the Committee during 2018/19.

Fees

The analysis of our audit fees for the year ended 31 March 2019 is included on page 18.

Services to Directors and Senior Management

PwC does not provide any services e.g. personal tax services, directly to directors, senior management.

Gifts and hospitality

We have not identified any significant gifts or hospitality provided to, or received from, a member of the Committee, senior management or staff.

Conclusion

We hereby confirm that in our professional judgement, as at the date of this document:

- we comply with UK regulatory and professional requirements, including the Ethical Standards issued by the Auditing Practices Board; and
- our objectivity is not compromised.

We would ask the Management Committee to consider the matters in this document and to confirm that they agree with our conclusion on our independence and objectivity.

These areas form part of your plan for improving corporate governance throughout the organisation and we are satisfied that you have proposals to achieve these improvements.

We identified no significant deficiencies in internal control to report to you.

Internal controls

Accounting systems and systems of internal control

Management are responsible for developing and implementing systems of internal financial control and to put in place appropriate arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the Statement of Accounts.

Reporting requirements

We have to report to you any deficiencies in internal control that we found during the audit which we believe should be brought to your attention.

No significant deficiencies in internal control were identified through our work, but the following matters are brought to your attention:

Deficiency	*Recommendation*
Detailed transaction reports: Our audit technology enables us to extract and analyse every transaction in a client's general ledger over a defined period through implementation of our HALO software. The transaction output extracted from ESPO's general ledger had several limitations, and did not include details of; - Whether a transaction had been manually posted by staff, or if it was automated within the ledger; - The date and time a transaction had been posted; - The individual who had posted a transaction in the ledger; and - Any description included in the posting, e.g: "month end payroll expenditure". We raised the same contol deficiency in previous years, because these limitations prevented us from undertaking a series of procedures in our journals testing.	Investigate the reporting capability of the general ledger software to ensure both management and auditors have access to full details of ESPO's financial transactions in the reporting period.

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Land and building valuation and underlying data As reported earlier in the reported there was a movement in the underlying data used by the valuer in the 2019 valuation compared to 2018, although there had been no additions or modifications to the warehouse and premises. It was advised this was due to RICS guidance rather than a change to the building size/configuration via any additions in the current financial year.	Consider whether the valuer should include a summary where (and why) the areas have changed (if no change to warehouse configuration or additions have occurred during the year by ESPO) and whether the plans have been formally updated or not.

We ask that the Management Committee, as those charged with governance, confirm to us that there are no additional matters relating to fraud that should be brought to our attention.

As part of work to address the risk of fraud, we use data auditing techniques to select journal entries which we believe have a greater risk of containing fraud or error.

We identified no issues to report to you as part of this work.

Risk of fraud

International Standards on Auditing (UK) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

Responsibility of the Management Committee

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

Your views on fraud

In our audit plan presented to the Management Committee in June 2019 we enquired:

- Whether you have knowledge of fraud, either actual, suspected or alleged, including those involving management?
- What fraud detection or prevention measures (e.g. whistle-blower lines) are in place in the entity?
- What role you have in relation to fraud?
- What protocols / procedures have been established between those charged with governance and management to keep you informed of instances of fraud, either actual, suspected or alleged?
- The following slide summarises how/why fraud might arise in an organisation.

In presenting this report to you we ask for your confirmation that there have been no changes to your view of fraud risk and that no additional matters have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud is included in the letter of representation.

Conditions under which fraud may occur

Management or other employees have an incentive or are under pressure

Incentive / pressure

Opportunity	Rationalisation/attitude
Circumstances exist that provide opportunity – ineffective or absent control, or management ability to override controls	Culture or environment enables management to rationalise committing fraud – attitude or values of those involved, or pressure that enables them to rationalise committing a dishonest act

Fees update

Fees update for 2018/19

Our actual fees are consistent with those agreed with the committee at the planning phase of our audit:

	2018/19 outturn (£)	2018/19 fee proposal (£)
Audit work performed:	45,750	45,750
Total	**45,750**	**45,750**

Note this does not include additional recharge for the CIPFA guidance documents purchased for the 2018/19 audit direct from CIPFA.

In the event that, pursuant to a request which Eastern Shires Purchasing Organisation (ESPO) has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. Eastern Shires Purchasing Organisation (ESPO) agrees to pay due regard to any representations which PwC may make in connection with such disclosure and Eastern Shires Purchasing Organisation (ESPO) shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, Eastern Shires Purchasing Organisation (ESPO) discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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