www.pwc.co.uk

Government and Public Sector

Leicestershire County Council

Report to those charged with governance (ISA 260 (UK&I))

September 2011

2010/11 Audit

www.pwc.co.uk

Members of the Corporate Governance Committee
Leicestershire County Council
County Hall
Glenfield
Leicester
LE3 8HD

13 September 2011

Ladies and Gentlemen

We are pleased to report the findings from our audit of your County Council and Pension Fund accounts.

Most of our work is complete and we expect to give unqualified audit opinions on the financial statements following approval by the Director of Corporate Resources. We will update you on our progress at the meeting on 26 September 2011.

My team and I look forward to discussing our report with you then.

Yours faithfully

PricewaterhouseCoopers LLP

Richard Bacon

PricewaterhouseCoopers LLP

Contents

Executive summary	***4***
Significant audit and accounting matters	***6***
Economy, Efficiency and Effectiveness	***12***
Risk of fraud	***14***
Fees update	***17***
Appendices	***18***
Appendix 1: Summary of uncorrected misstatements	19
Appendix 2: Recent PwC Publications	***20***

Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In April 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any member or officer in their individual capacity or to any third party.

Executive summary

Introduction

We have pleasure in reporting the significant matters from our audit programme, as required by Auditing Standards, before you approve the accounts and we sign our opinion. We would like to thank the Director of Corporate Resources and his staff for the considerable help and assistance provided to us during the course of our audit.

This summarises our view of your accounts and audit performance:

		Comments
Quality of accounts and working papers	● (G)	Your draft accounts (including pension fund) were submitted to us ahead of the June deadline and were of a high quality. Supporting working papers were good and provided on time in the majority of cases, although we had some delays when requesting information from the departments.
Readiness for start of audit	● (G)	Working papers were generally ready at the start of the audit and key staff were available so that we could start our work on the first day we arrived.
Availability and responsiveness of staff	● (A) to ● (G)	Staff throughout the Council are always responsive and helpful. They are committed to the audit process and are always looking to improve. The finance team are dealing with significant change currently, particularly with the Shared Service project, and this did impact on the efficiency of the audit process at times. We have already discussed our reliance on key individuals and will work with the team to identify further improvement for next year.
Significant audit and accounting issues	● (G)	We did not identify any significant audit and accounting issues during the audit. The net impact of the proposed adjustments would be a £147,000 increase in the general fund balance.
Deficiencies in internal control systems	● (G)	We have not identified any material deficiencies in Internal Control.
Use of Resources/Value for Money Conclusion	● (G)	We anticipate issuing an unqualified value for money conclusion. We presented our view on your Medium Term Financial Strategy at an earlier meeting.

Key

● Red (R) – significant improvements required

● Amber (A) – some improvements required

● Green (G) – no or some minor improvements required

An audit of financial statements is not designed to identify all matters that may be relevant to you and does not ordinarily identify all such matters.

Changes to audit approach

Under Auditing Standards[1] we have to tell you about the significant findings from our audit before giving our audit opinion. We agreed with you that "those charged with governance" is the Corporate Governance Committee.

We agreed our County Council plan with you in November 2010 and our pension fund plan in February 2010 and we can confirm that there has been one change to our audit approach for the County Council.

When we received the draft accounts, we revised our materiality levels to reflect the level of risk associated with the Council and the year end position. Our overall materiality for the County Council is £20.4 million calculated as a percentage of expenditure; this represents the level at which we would consider qualifying our audit opinion.

[1] the Auditing Practices Board's International Auditing Standard (UK and Ireland) 260 (ISA (UK&I) 260) - "Communication of audit matters with those charged with governance"

Significant audit and accounting matters

We have to tell you about the key findings from the audit sufficiently promptly for you to take appropriate action.

Accounts

We have completed the audit of the financial statements including the pension fund accounts in line with Auditing Standards apart from the following:

- completion of our internal review and quality control procedures;
- our review of the final version of the financial statements with all of the agreed changes having been made;
- approval of the financial statements by the Constitution Committee; and
- receipt of all relevant signed statements and the management representation letter.

We will update the Corporate Governance Committee on our progress at its meeting on 26 September 2011.

Accounting issues

Implementation of International Reporting Standards (IFRS)

Local Government had to prepare IFRS accounts for the first time in 2010/11. Your finance team planned for these new requirements effectively, starting with an impact assessment two years ago. This approach resulted in an early understanding of the requirements, recognition of the scale of the task and a comprehensive plan. Your first set of accounts was delivered on time and is better than others we have seen.

The accounts were received on time on 30th June 2011, were of a good standard and contained no material omissions. Our IFRS expert reviewed the accounts to check if the new requirements were fully met, and found a number of consistency points which have been amended, none of which have an impact on the amounts to be met by council tax payers.

The Council has generated a good set of IFRS accounts setting a high standard for the future.

Valuations
Your draft accounts include fixed assets with a net book value of £979.9 million, largely made up of land and buildings (£697.3 million) and infrastructure assets (£248.4 million). You have to keep the values up to date.

The Council's accounting policy is to include land and buildings in the balance sheet at open market value for existing use or at depreciated replacement cost for specialised assets where there is no market. You do this by reviewing the top 20 assets every year, revaluing a fifth of your other assets every year and on completion of a capital scheme above £100,000.

During the year your policy resulted in the revaluation of 64% of your estate, and 85% over the last two years. The change in value on revaluation in the year was downwards by £23.1 million.

The Building Cost Information Service (BCIS) provides indices for revaluing specialised assets, showing a range of between 7 to 10% increase in the value of these types of assets over last year and a 10 - 20% increase over 2 years. Your valuers applied local knowledge of the area and amended the indices to take into account the types of assets being valued. In each case, the index applied as a part of the five year programme was within the range suggested by BCIS.

'The value of other specialised assets held by the Council which had a combined net book value of £202 million have not been updated for the change in indices due to the 5 year rolling valuation programme. Application of the BCIS indices indicated that these assets are undervalued by £7.4 million or 1%. This is not material and we did not propose that the Council adjust for this.

Existence of Assets
We have tested that assets exist by physically inspecting a sample of your land and buildings. We have also tested that these assets belong to you by examining title deeds. We did not find any matters to report to you and found that the information held by the Council was extensive and easy to access. This has not been our experience at other Councils.

Capital Expenditure not Increasing Value
Most capital expenditure results in new or improved assets, but some capital cost, such as removal of asbestos or refurbishment, although funded from capital does not enhance an asset. The Council has to review capital costs, decide which enhance assets, capitalise those and impair the rest.

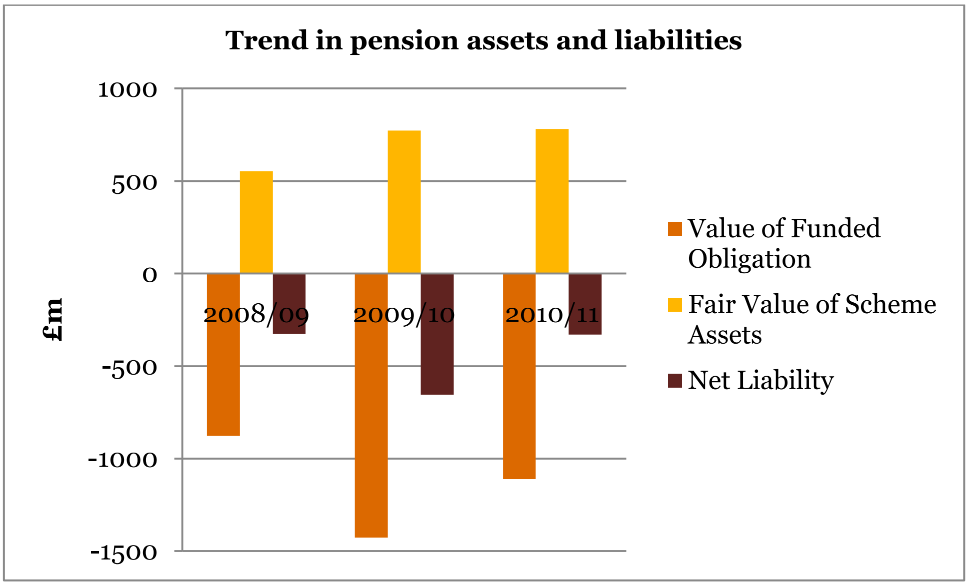
Our review of the non enhancing capital expenditure identified that in three instances transactions that did not relate to Council owned assets and instead related to capital grants given to voluntary organisations and should therefore be accounted for a revenue expenditure funded from capital under statute (REFCUS).

In response to our findings the Council has undertaken additional work to identify any additional items that may fall into this category. We have discussed this matter with the Finance Team who have adjusted the accounts for this. The net impact of this adjustment is to reclassify expenditure between headings. There is no impact on the general fund.

Payroll
We have performed an analytical review on your payroll costs. This involves taking last year's costs and adjusting for changes in employee numbers and national pay awards. We were pleased to note that we did not encounter any problems in this area and staff were helpful and provided responses to queries quickly.

Changes in the Pension Scheme

One of the most material and volatile estimates in the accounts is your pension liability, shown below:



The Government announced in June 2010 that the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) would be used to measure price inflation for public sector pension schemes, resulting in significant reductions in liabilities, in your case from £654 million at 31 March 2010 to £330 million at 31 March 2011. A "gain" has been taken to the Comprehensive Income and Expenditure account as an exceptional item, and the liability in the balance sheet has been reduced accordingly.

The results of the triennial funding review of the Pension Scheme as at March 2010 are now reflected in the accounts. Between the dates of valuations, the assets allocated for each employer are updated using a "roll forward" approach (where previous balances are adjusted to account for known trends). This represents an estimate in the Council's accounts. The value of your pension assets have as a result increased by £7 million during the 2010/11 financial year. This actuarial gain has been taken to the Council's Comprehensive Income and Expenditure account and reserves.

The Pension Fund gives membership details to the Actuary to calculate the figures for the accounts. We check that the membership numbers used by the Actuary agree to the Council's records and found that they agreed.

Matching of transactions to the correct period

For certain types of transactions, and in accordance with the Council's accounting policies, the Council do not currently apportion certain items of expenditure to the financial period that they relate. This is limited mainly to IT maintenance contracts. The finance team have performed a detailed analysis of these transactions and confirmed that £147k of transactions should not be accounted for as expenditure in 2010/11 and instead should be prepayments. We are satisfied that this does not represent a material misstatement, and the Council has agreed to amend its approach in 2011/12.

Misstatements and significant audit adjustments

Appendix 1 reports the two uncorrected misstatements found during the audit (other than trivial ones). The first of which relates to finance leases that the Council has identified as part of the IFRS restatement process. These leases are for vehicles that have historically been accounted for as operating leases and therefore do not appear on the Council's balance sheet. The reassessment of leases under IFRS indicated that these should in fact be finance leases and on the Council's balance sheet. The leases are due to come to an end in the next year and the total value of payments outstanding is £133k. We are therefore satisfied that this does not represent a material misstatement. The second uncorrected misstatement relates to apportionment of transactions to the correct financial year as detailed above. Adjusting for these two items would have the effect of increasing the surplus on the general fund in 2010/11 by £147k. We have discussed this matter with the Director of Corporate

Resources and while we do not anticipate that the Council will amend for these items, we are required by auditing standards to report it to you. These errors are not material and will therefore not impact on our opinion.

In total we identified two other misstatements with a total value of £7.974 million that do not impact on the general fund and related only to reclassification of items on the Balance Sheet. We have discussed these with the Director of Corporate Resources who has agreed to adjust for these errors.

We are pleased to report that there were no adjustments proposed for the Pension Fund accounts.

Significant accounting principles and policies

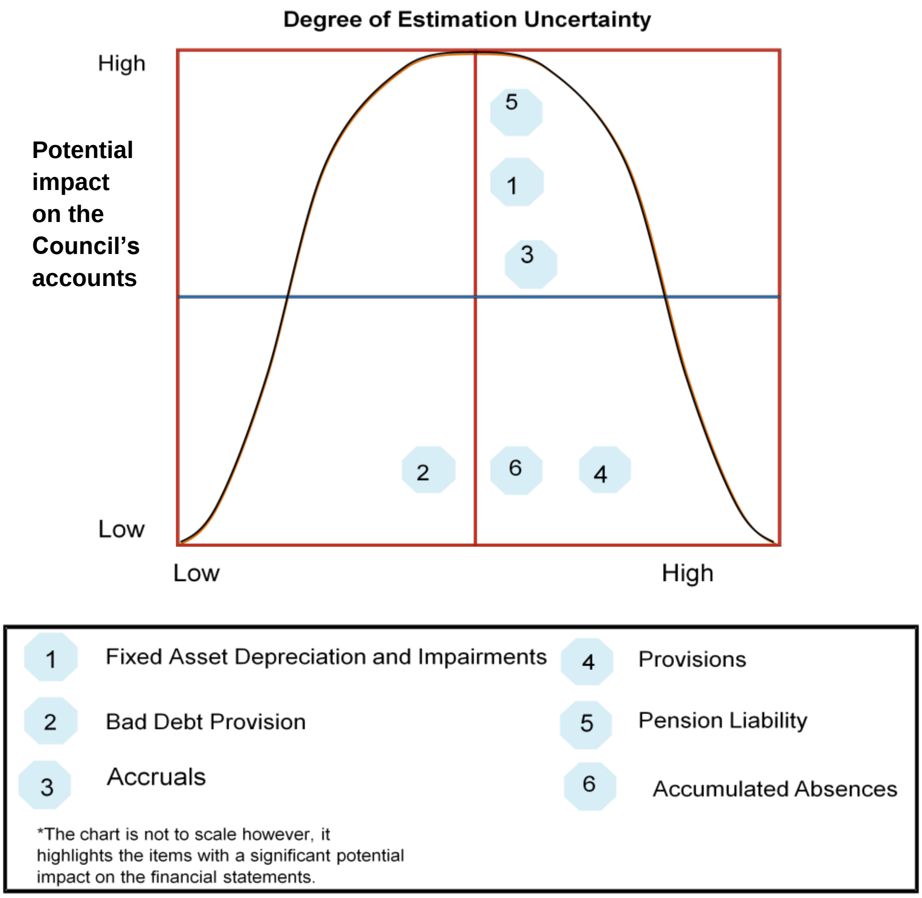
You have to choose and review regularly the accounting principles and policies you use in preparing the accounts and disclose them in the accounts. We ask you to confirm in the Letter of Representation that you have continued to review them and have considered the selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on your financial statements.

Judgments and accounting estimates

The following significant judgments and accounting estimates were used in the preparation of the financial statements:

- **Property, Plant and Equipment - Depreciation and Valuation -** You charge depreciation based on an estimate of the Useful Economic Lives for the majority of your Property, Plant and Equipment (PPE). This involves a degree of estimation. You also value your PPE in accordance with your accounting policies to ensure that the carrying value is true and fair. This involves some judgement and reliance on your internal valuers.
- **Bad Debt Provision** – Your Bad Debt Provision for sundry debtors is calculated on the basis of age and an assessment of the potential recoverability of invoices. There is an inherent level of judgement involved in calculating these provisions and you rely on the knowledge of the Departments for information on specific transactions.
- **Accruals -** You raise accruals for expenditure where an invoice has not been raised or received at the year end, but you know there is a liability to be met which relates to the current year. This involves a degree of estimation. The level of manual accruals raised as 31 March 2011 is £56.8 million, compared with £44.5 million as at 31 March 2010.
- **Provisions**: Provisions at 31 March 2011 total £7.5 million (£6.5 million as at 31 March 2010 and £5.3 million as at 31 March 2009). Because provisions are liabilities of an uncertain timing or amount, there is an inherent level of judgement to be applied.
- **Pensions:** See above. You rely on the work of an actuary in calculating these balances.
- **Provision for accumulated absences -** You calculate your accrual for untaken holiday and employment benefits at the year-end based on returns completed by managers. You apply an average calculation based on these returns when you have had no response. This is a new requirement under IFRS and your 31st March 2011 balance is £12.2 million.

We have assessed below the degree uncertainty applied in forming key judgements on the year-end financial statements.



We will ask you to represent to us that you are satisfied with the assumptions made in arriving at these judgements and estimates in the accounts.

Disagreements with management

There have been no disagreements with management during the course of the audit which individually or in aggregate could be significant to your financial statements or our audit report.

Management representations

The final draft of the representation letter that we are requesting management and those charged with governance to sign is to be presented at this meeting.

Related parties

There are no significant related party matters to be communicated.

Audit independence

We confirm that, in our professional judgment, as at the date of this document, we are independent of the Council, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.

Accounting systems and systems of internal control

You have to develop and implement systems of internal financial control and put in place proper arrangements to monitor their adequacy and effectiveness. As auditors, we review these arrangements for the audit of the financial statements and our review of the Annual Governance Statement.

We have no significant control issues to bring to your attention. We report minor internal control issues separately to management and action plans will be agreed with officers.

Annual Governance Statement

Local Authorities are required to produce an Annual Governance Statement (AGS), which is consistent with guidance issued by CIPFA / SOLACE: 'Delivering Good Governance in Local Government'.

We reviewed the draft AGS to consider whether it complied with the CIPFA / SOLACE 'Delivering Good Governance in Local Government' framework and whether it is misleading or inconsistent with other information known to us from our audit work. We found no areas of concern to report in this context.

Economy, Efficiency and Effectiveness

Audit Approach

We have to conclude whether you have put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources.

Our conclusion is based on two criteria:

- You have proper arrangements for securing financial resilience; and
- You have proper arrangements for challenging how you secure economy, efficiency and effectiveness.

Unlike in previous years, we have not had to reach a scored judgment on these criteria and the Audit Commission has not developed 'key lines of enquiry' for each criteria. Instead, we have determined a local programme of audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities.

Our audit plan identified a particular area of focus:

- Medium Term Financial Strategy (MTFS).

We anticipate issuing an unqualified value for money conclusion. The main points of our work in this area have been detailed below.

Medium Term Financial Strategy

Our audit plan highlighted specific value for money risk in relation to your savings requirement and financial plans over the next few years. We agreed in the audit plan that we would review your Medium Term Financial Strategy (MTFS), comparing it to others, and also review your management arrangements.

We have already reported to members on the results of this work in a separate communication. However a summary of the key points are reported here for you information:

- You have set a challenging and robust MTFS after going through a process of extensive consultation.
- You have demonstrated in the past that you have robust programme management arrangements in place and that you achieve the savings targets which you have set yourself. However, the scale of the challenge for 2011/12 and beyond is greater than that which you have previously experienced; You have applied a number of prudent assumptions in setting your MTFS. The challenge now is for you to carefully monitor your performance against these assumptions and amend your plans as appropriate;
- The Audit Commission value for money profile, whilst backwards looking, identifies a number of key areas where the Authority is providing services which can demonstrate value for money against your statistical "nearest neighbours";
- You need to focus on how you are going to demonstrate value for money going forward given that a number of national indicators have been withdrawn; and
- You have set aside a significant level of earmarked reserves and a level of contingency to manage future cost pressures. Whilst these are larger than in other similar Local Authorities, we believe that you have taken a prudent approach in setting your MTFS.

Despite the preparation you have undertaken and the prudent assumptions you have made, there continues to be a risk around delivery of your MTFS. The main risks you face as an organisation to non achievement of your medium term financial strategy can be summarised as follows:

Slippage: you may not be able to achieve the savings you want either from a service reduction or through efficiencies

Timing: The timing of savings, service reductions and funding announcements will impact how you deliver against your MTFS

Assumptions: If the assumptions applied turn out to be false, this would have a significant impact on your ability to deliver a balanced budget over 5 years.

In conclusion, we have reviewed your MTFS and the assumptions which lie behind it. We have compared you with other, similar Local Authorities and taken into account our wider understanding of the Local Government sector. Our work in this particular area has not identified any issues which would lead to a qualified value for money conclusion.

Risk of fraud

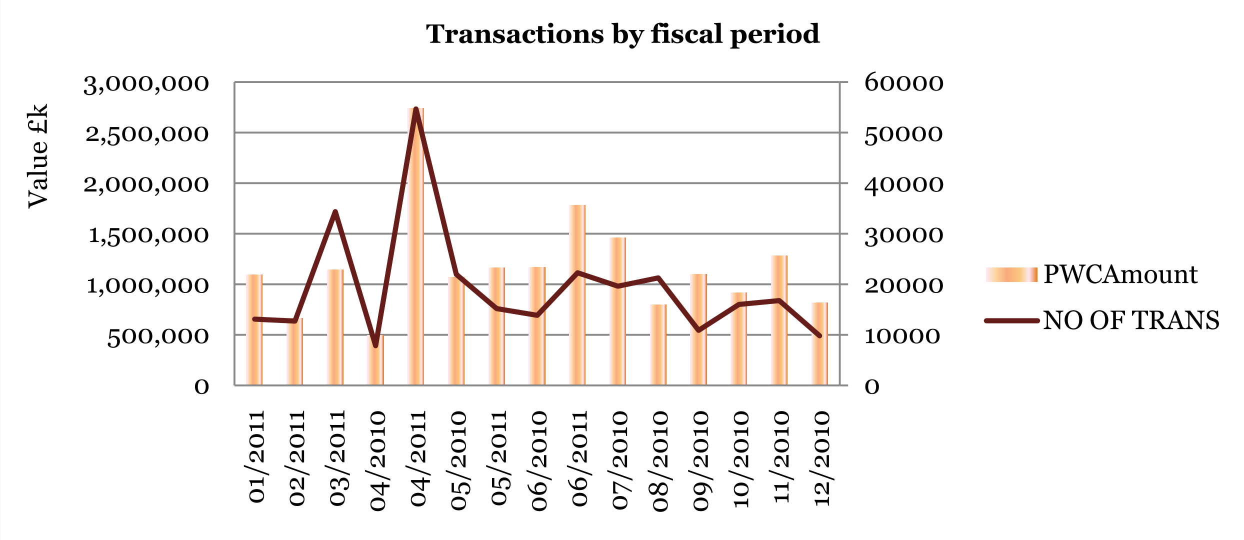
Audit Plan

We included two fraud risks in our audit plan:

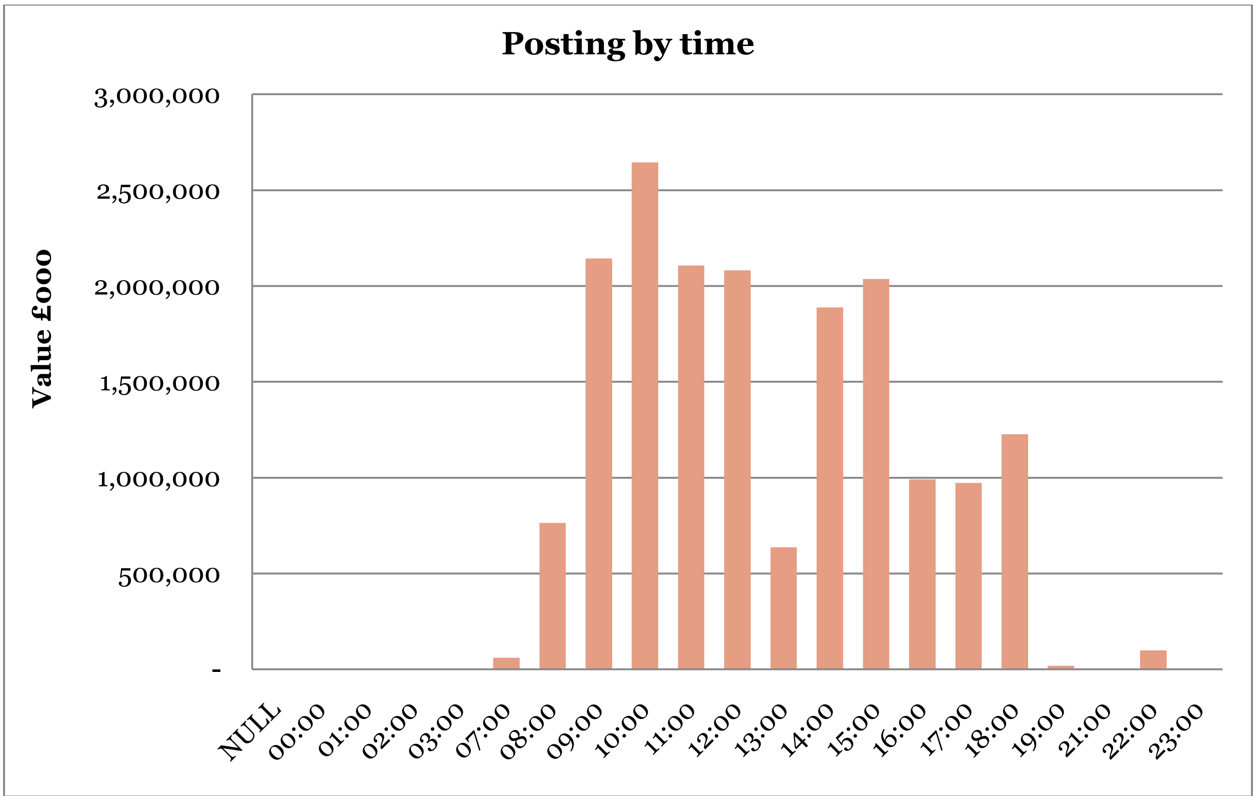
Audit plan risk	Examples of how this could occur	Audit Update
Revenue and Expenditure Recognition There is a risk that you could adopt accounting policies or treat income and expenditure transactions in such a way as to lead to material misstatement in the reported revenue position. This is a mandatory risk required by auditing standards.	In any organisation there is a risk of incorrectly recognising either revenue or expenditure. The incentive may be derived from financial pressure or the need to operate within budget. For example, fraud could manifest itself through: • Recognising income in an incorrect period; • Raising provisions against accounts receivable which are not reasonable; or • Raising accruals which do not relate to expenditure which has occurred in the year to date.	Our work did some IT maintenance contracts that are not recorded in the correct period. We were satisfied with the explanations provided to us by the Council. In addition, the values were not material and have been included as an uncorrected misstatement in this report. This is not considered to be fraudulent in nature.
Management Override of Controls In any organisation, management may be in a position to override the financial controls that you have 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 significant risk and adapt our audit procedures accordingly. This is a mandatory risk required by auditing standards.	There will always be a risk of management overriding controls in any organisation. Typically this might occur where segregation of duties have broken down or collusion is present. The sort of areas which are susceptible to this type of fraud include: • Manual journals; and • Key estimates and assumptions such as asset valuations, provisions and accruals.	Elsewhere in this report we highlight some matters concerning key estimates and assumptions, however none of these were considered to be fraudulent in nature.

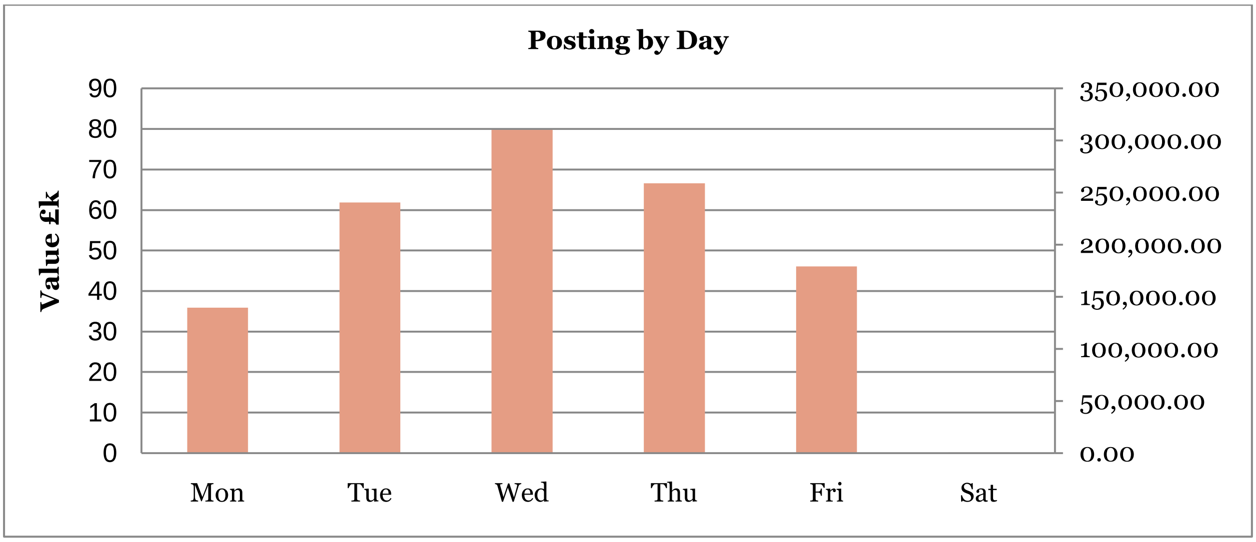
Journals

As noted above, a key area susceptible to fraud in financial reporting is around journals. As part of our audit work, we used Computer Aided Audit Tools (CAATs) to interrogate the journals posted by the Council in order to identify any potential areas of risk. Our approach in this area is based on a wider conception of what are deemed to be "at risk" transactions. The results of some of our tests have been documented below:



There were a total of 290,000 manual journals posted in year (including the close down period) to the value of over £17.7 billion. Automated journals were processed in addition to this. These have been excluded from our graph as are less exposed to risk of error.





Journals posted out of hours or at weekends are deemed subject to a higher risk of management override. A total of 120 journals totalling £21 million were posted at the weekend. 5,895 out of hours journals totalling £117.9 million were raised. We have targeted our testing to look at material journals posted at unusual times.

All journals should be approved. We found that the processes for journals are inconsistent across the Council and that not all journal transactions are approved.

The Council should improve its processes in relation to journal posting and investigate the use of automated controls within Oracle to manage the risks in relation to manual journals.

Oracle GATE

GATE is an audit tool that we use to analyse how your Oracle system is set up. We used GATE to look at how your system is configured in order to target our audit work in a risk based way. GATE enables us to look at your system in its entirety and form a view on the whole control environment in a way that testing a sample of individual transactions cannot.

We found that, in the main, the system was configured in line with good practice but that there were some areas where the configuration needs changing or where additional controls may be required. Given the move to a shared service environment, now is a good time to reassess the control framework you have in place and consider if it does the job you want it to.

We have provided officers with a detailed listing of all of our findings of this review and we are working with them to agree an action plan to take these forward.

Fees update

Fees update for 2010/11

We reported our fee proposals as part of the Audit Plan for 2010/11. Our actual fees were in line with our proposals.

	2010/11 actual	2010/11 proposed
County Council	£190,000	£190,000
Pensions Fund	£46,000	£46,000
Total	**£236,000**	**£236,000**

Appendices

Appendix 1: Summary of uncorrected misstatements

The following errors have not been adjusted by management, and we need you to consider it and decide whether it should be amended. If the error is not adjusted we need a written representation from you explaining your reasons for not making the adjustment.

No	**Description of misstatement (factual, judgemental, projected)**		**I&E statement**		**Balance sheet**	
			Dr	**Cr**	**Dr**	**Cr**
1	Dr Plant Property and Equipment Cr Finance Lease Liabilities The Council's assessment of leases as part of the move to IFRS identified a number of vehicle leases that are accounted for as operating leases but that should be finance leases. This represents correction of the potential impact on the financial statements should the leases be accounted for correctly.	Factual	-	-	£133k	£133k
2	Dr Prepayments Cr Expenditure Testing of the Council's accounting policies identified that certain items of expenditure are not matched to the period to which they relate. This represents the quantification of the error in relation to this.	Factual	-	£147k	£147k	-
Total uncorrected misstatements			-	**£147k**	**£280k**	**£133k**

Appendix 2: Recent PwC Publications

As part of our regular reporting to you, we plan to keep you up to date with the emerging thought leadership we publish. The PricewaterhouseCoopers Public Sector Research Centre (PSRC) produces a range of research and is a leading centre for insights, opinion and research on best practice in government and the public sector. The reports of the Public Sector Research Centre can be accessed at http://psrc.pwc.com/index.html.

Accounting developments

There are a number of minor updates to the CIPFA Code of Practice on Local Authority Accounting in the UK 2011/12

The main accounting change relates to the adoption of the requirements of FRS 30 Heritage Assets in the CIPFA Code. This requires heritage assets to be measured at valuation in normal circumstances, and permits authorities to use the measurement and disclosure principles of FRS 30 for Community Assets.

Creating Auditor Choice

On 13th August 2010, Secretary of State for Communities and Local Government Eric Pickles, announced the end of the Audit Commission, signalling a new era of public sector audit.

What followed was a period of uncertainty and speculation with the publication of the 'future of local public audit' consultation paper in April 2011, providing much needed structure to the debate. The political and economic backdrop to the demise of the Audit Commission has been one of significant change, with substantial public sector spending cuts.

In this environment, public spending is continually thrust into the public eye, leading to questions about where taxpayer's money is being spent and why. Never before have such sweeping changes been proposed to the way in which assurance is given to the public about how its money is spent. Local authorities want the opportunity to select their own auditors and the proposed changes will provide competition and choice. This Talking Points publication considers what role audit plays in the public sector today, explores what the benefits of audit choice will be to the public sector and to the public at large, and assesses the current proposals of the consultation. The audit of public sector organisations should build public trust in how money is spent and accounted for and auditor choice, if implemented in a timely and appropriate manner, provides an opportunity to achieve real change for the better.

Is PFI working? Buying excellent settling for average

Since the Coalition government came into power and the focus of Whitehall has fallen on the fiscal deficit, the Private Finance Initiative (PFI) has become a much maligned symbol of perceived government waste and poor value for money.

In early 2011 the Treasury announced a pilot review of a single hospital PFI in Romford to assess the scope for cost savings within the PFI construct, to be carried out by "an experienced team of commercial, legal and technical advisors"1. Along with the January Treasury draft guidance note entitled "Making Savings in Operational PFI Contracts" this review has been seen by some as a way to answer the repeated questions posed to the Prime Minister on the subject, resulting in campaigns such as that led by Jesse Norman MP proposing a rebate from the private sector PFI parties.

This Talking Points publication will argue that whilst there are constructive proposals within the Treasury guidance and that Jesse Norman's campaign can be easily understood at an emotional and political level, neither succeeds in addressing the real obstacle to ensuring success in PFI. According to a survey performed by Ipsos MORI in 2008 81% of PFI projects had not gone through any value-testing exercise2 since they had been signed. Public sector contractual rights are going unused, this is the elephant in the room; there is an expensively negotiated contract gathering dust at the bottom of a drawer that must be reviewed to unlock and ensure full value and excellent service for the public sector.