A review of the causes of delay in completing the Northampton Borough Council Statement of Accounts 2016/17 by LGSS Finance on behalf of NBC

1. Introduction

1.1. The NBC S151 Officer has requested that a report be presented to the Audit Committee setting out the detail behind the causes of delay to the 2016/17 NBC Statement of Accounts to provide the Committee with the opportunity to comment and understand fully the issues. This report has been prepared by officers in both the LGSS Integrated Closedown team and the LGSS NBC Finance Business Partner team, with some additional comments/observations by KPMG.

1.2. A KPMG update report was also presented to the Audit Committee in July. This reported the position as at June 2018 and is attached as Appendix 1 to this report. This includes a useful commentary from the external audit perspective and a timeline for the period to June.

1.3. The following sections of this report provide commentary from the NBC / LGSS perspective on each of the main issues that have contributed to the delay in finalising and signing off the 2016/17 accounts.

2. Fixed Asset Valuations – General

2.1. Initial concerns were raised by KPMG (the external auditor) in June 2017, with further concerns highlighted during September 2017. These were concerns over the accuracy of the valuations of certain properties owned by the Council. These concerns centred on the valuation methods applied by both internal and external valuers and the quality of supporting records.

2.2. Following an analysis and evaluation of the concerns raised, all of the properties impacted by these issues were identified and appropriate responses were formulated by colleagues in Finance and Asset Management.

2.3. New valuations were required for all properties that had been valued internally, and in order to mitigate the lack of permanent staff and, in some instances, the absence of appropriate valuation records in the NBC client assets team, external valuers (GVA) were appointed in November 2017. Their instruction was to provide robust new 2016/17 valuations for all assets that had been valued by the internal assets team.

2.4. Other assets had already been revalued by external valuers (Underwoods) and this exercise was revisited. This process involved a detailed review of the valuation documentation and additional information was sought. There had been little or no review of these valuations by the NBC client assets team when they were delivered, which would have highlighted some of the striking inconsistencies that existed.

2.5. The work required to clear the resulting concerns was largely undertaken during the period from October 2017 to May 2018, and was the sole focus during this time.

2.6. The following asset categories were impacted (but see section 2 on Council Dwellings):

I. Investment Assets;

II. Operational Properties; and

III. Assets held for sale.

2.7. This valuation exercise took some time to deliver, with reports and backing information received as follows:

I. GVA delivered the replacement for the internally delivered valuations on 29 January 2018;

II. GVA delivered further, 'sensitive' valuations during February, March, April and July 2018; and

III. Underwoods provided further background information in November 2017.

2.8. Once delivered, the new and enhanced valuations were subjected to intense scrutiny by the auditor, as a result of the NBC Audit being considered 'high risk' therefore having lower thresholds for materiality. A series of follow up questions were received from both the KPMG audit team and an in-house KPMG valuation expert, who was supporting that team.

2.9. Follow-up questions were received regarding the Underwoods valuations during November, December and January. Although responses to the majority of these queries were provided by the end of February 2018, the January queries were repeated in May because of an ongoing absence within the KPMG team. Most queries were cleared in June/July 2018.

2.10. There is no doubt that progress through the audit has been slowed significantly by the availability of the robust valuation data that should have been held by the assets team, especially as many of the valuations were actually completed by internal valuers. It should be noted that whilst there has been a significant lack of resource and expertise in the assets team, one individual agency worker has been pivotal in taking ownership and working with finance staff to resolve these issues.

2.11. There is also no doubt that some of the delay in finalising this work arose because of resourcing issues within the KPMG team, not least as a result of the loss of a key colleague (the valuations expert) to illness. However this only had an impact as the audit had exceeded its expected resource window for KPMG, who had been 'booking and releasing' key staff over a period of time awaiting information. As a direct consequence, the questions received were sometimes based on misunderstandings or were a repeat of earlier queries. Additionally, this situation often resulted in a significant lag between the delivery of evidence and the receipt of follow-up questions. However, some of this is perhaps to have been expected due to the need for KPMG to work on other already planned audits and assignments therefore creating a pressure for the audit team. KPMG have highlighted they could not hold a constant Audit Team for the whole period on standby, without material cost implications to NBC. Once the planned audit window had past, there were some resource availability issues for KPMG, but attempts were made to keep staff consistent and available, but with due regard to seeking to manage the costs for NBC.

3. <u>Fixed Asset Valuations – Council Dwellings.</u>

3.1. Outstanding issues associated with the valuation of the Council's housing stock began to arise during February and March 2018. The core issue was that incorrect valuation reports were used when creating the accounts presented to Audit Committee in September 2017, which should have been picked up in the Quality Control checks.

3.2. The existence of problems in this area was identified in January 2017, where an Asset Management and Finance meeting noted:

> *"NBC has never assessed the appropriateness of beacon groups and this is a fairly substantial piece of work. The 1st April 2016 valuation showed a 4.08% average uplift from values at 31st March 2016. This shift does indicate the need for an assessment of the appropriateness of*

beacon groups to be urgently carried out, especially as there were underlying movements ranging from -15% to +20%."

3.3. During the period from April 2016 to September 2017, the valuation process became chaotic, with three valuation approaches delivered by three different organisations. All had applied the wrong social housing discount factor and this was not picked up by the internal assets function.

3.4. Once the issue with the discount factor was highlighted in September 2017, (KPMG state this was identified by them in July 2017) the year-end valuation was corrected and the accounts amended for this change. The opening position, however, was not updated at the time, despite this being the key driver for the calculation of depreciation in the year. In February 2018, as the Housing valuations were pulled forward for scrutiny, the Finance team undertook a review of the movement on the accounting statement and highlighted that this step was missed.

3.5. A substantial piece of work has been required in order to correct this situation, including obtaining a new valuation report at 1 April 2016 that applied the correct social housing discount factor. This was delivered on 20 June 2018, reviewed by Finance / Assets and cleared by KPMG in July 2018.

3.6. The amendments then required in the accounts were numerous and complex. Having been advised that these entries should not be loaded to the Fixed Asset System (RAM), the team prepared to replicate the actions of that system within a spreadsheet. This process was extremely complex but succeeded in providing verifiable data at a high level.

3.7. At this point, discussions with the software provider for RAM identified an approach that would allow the data to be loaded to the system. This was considered beneficial by both the Finance team and KPMG, as it would provide a more robust approach, a complete audit trail and continuity with previous and future records.

3.8. Commissioned on 2 August 2018, this involved the removal of the data generated by the incorrect valuation report and the upload of the details from the new, correct report, while leaving all other asset data intact.

4. Working Papers and Accounting Records

4.1. Although many working papers were produced to the required standard in support of the audit, which started in June 2017, to produce the September 2017 draft accounts, a number were of poor quality and created additional queries, uncertainty and delay. For context, there are over 100 audit records required, which are delivered by different parts of LGSS and NBC.

4.2. There is evidence that the time pressures experienced by the team at that time compromised the review and quality assurance process during the compilation of the accounts in June 2017, presented to Audit Committee in September 2017. This would have appeared to have led to issues around accuracy and internal consistency. Overcoming these issues during the ensuing period has created some delay as working papers and supporting analyses needed to be reworked to satisfy the auditors. This work was cleared, however, by the end of January 2018.

4.3. Additionally, year-end working papers originally produced for CIES/MiRS/ BS had been split up for the first time in 2016/17, leading to consistency checks being missed.

5. Mapping of the trial balance (TB) to the Statement of Accounts

5.1. The complex amendments identified from the work on property valuations resulted in a large number of changes throughout the accounts. In feeding these transactions through the financial system, KPMG sought assurance in respect of the mapping of ledger codes to the primary statements.

5.2. Consequently, there has been a need to confirm at the most detailed level that the Statement of Accounts document accurately reflects the contents of the Council's financial system. Although this step was not undertaken for the September accounts, and LGSS believe, had not been required in previous years, the Finance team agreed with KPMG that this assurance was required in order to clear the audit. KPMG advise this is standard practice and ordinarily conducted at the end of an audit and does not normally highlight any issues.

5.3. Although this process allowed the team to confirm that the September accounts were materially complete and that no material balances or transactions were omitted, it also highlighted a number of immaterial anomalies (errors) and a couple of issues:

I. The need for a series of manual adjustments in the September accounts arose because of the way the financial system is configured. As the financial system is used for a number of reporting purposes, the statutory format of the accounts has always required a merger of two different code structures. Although this process delivers the majority of analysis required, a small number of manual adjustments have always been necessary.

II. This situation was made significantly more complex by the 2016/17 change in the format of the Income and Expenditure Statement and a number of further manual adjustments to the system data structure were required. KPMG observe this was a national change to reporting requirements and known in advance of the audit itself.

5.4. The requirement for full TB mapping was first discussed in February 2018 (KPMG state it was referenced in their PBC in January 2017 and first discussed in October 2016) and a presentation that demonstrated that all codes had been applied was completed by the Finance Business Partner and Integrated Closedown team during March and early April.

5.5. On 26th April 2018, a session was held through which LGSS finance (both NBC Finance Business Partner and Integrated Closedown team staff) provided a detailed presentation of the mapping process and audit trail to a KPMG Audit Manager, with the NBC S151 Officer in attendance.

5.6. This presentation was taken away by KPMG and, on 1st May 2018, another KPMG Audit Manager on the NBC audit stated that the concerns centred on one year-end transaction included within the trial balance, designed to 'sweep' the balances from the revenue codes at the year-end onto the general fund balance. At this point, KPMG required an explanation of this activity.

5.7. LGSS Finance responded to this query on 2nd May 2018 setting out the explanation of these codes and offering a conference call.

5.8. On 24th May 2018 LGSS Finance were made aware, through the NBC S151 Officer, that KPMG had referred this issue to their 'technical team' without discussing it further with officers. There were no other communications from KPMG on this issue at this time, despite both the NBC S151 Officer and LGSS Finance querying progress against this outstanding issue on a regular basis. (KPMG advise that this topic was covered during the regular 'catch-ups' with LGSS Closedown Team)

5.9. On 19th June 2018, the NBC S151 Officer emailed KPMG specifically requesting that this area be looked at and for KPMG to visit the LGSS Finance team if further explanation was required.

5.10. On 2nd July 18 KPMG hosted a conference call between their audit team, KPMG technical team and LGSS Finance to discuss the TB mapping work. Further discussions and a series of different presentations were produced after this call in order to clarify the Council's approach. These were delivered to both the KPMG audit and technical teams on 5th July 2018. Following a face-to-face meeting on 12 July 2018 with the audit and technical teams, the Finance team were asked to simplify the presentation through modifying parts of the accounting code structure, allowing a clearer reconciliation between the accounting statements and the financial system rather than on a spreadsheet. Further discussions ensued to obtain clarity on the output KPMG required, and this work is currently being completed

5.11. The requirement for manual adjustments in this reconciliation does highlight the fact that the configuration of Agresso has not kept pace with developments in the Accounting Code that occurred in 2016/17.

5.12. Due to KPMG's requirement for the re-mapping process for the 2016/17 presentation of the Income and Expenditure Statement to be transacted on the General Ledger, this set up will be fit for purpose for the Statement of Accounts going forward.

6. Conclusion

6.1. This report demonstrates that there have been some very specific yet significant issues that have resulted in the delays to the 2016/17 accounts. These issues have also been discussed in the context of the 2017/18 accounts to ensure that a similar situation does not materialise for the audit of those accounts. (Specifically around asset valuations and accounting treatment and the quality of working papers).

6.2. Finally, it is also worth pointing out that the rest of the audit, particularly with regards the revenue aspects of the Statement of Accounts went well and was completed to time by both parties.