



External Audit Progress Report 2016/17

Northampton Borough
Council

June 2018

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The contacts at KPMG in connection with this report are:

Andrew Cardoza

Director
KPMG LLP
T: +44 (0)121 232 3869
E: andrew.cardoza@kpmg.co.uk

Daniel Hayward

Senior Manager
KPMG LLP
T: +44 (0)121 232 3280
E: daniel.hayward@kpmg.co.uk

Katie Scott

Manager
KPMG LLP
T: +44 (0)121 232 3632
E: katie.scott@kpmg.co.uk

Clementine Macliver

In-charge
KPMG LLP
T: +44 (0)121 232 3011
E: clementine.macliver@kpmg.co.uk

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Summary for Audit Committee

Since we last communicated to the Audit Committee in September 2017, we have made progress on key areas which we have stated were outstanding.

We formally wrote to the Chief Finance Officer on 29 September 2017 stating that we had identified a number of issues relating to the Authority's fixed assets, including but not limited to the valuation of social housing, other land and buildings, and investment properties, as well as the methodology adopted towards componentisation¹.

Cumulatively, the Authority's fixed assets represent the biggest balances on your balance sheet, at £599 million².

Due to the number of areas of concern and errors found, we were not able to obtain sufficient assurance that your financial statements present a true and fair view prior to the statutory deadline of 30 September 2017.

This report summarises progress made since September 2017.

¹ See copy of letter in Appendix 1.

² Per the original draft financial statements, presented to Audit Committee on 3 July 2017

Property, Plant & Equipment (PPE) and Investment Properties

We last reported in our *External Audit Report 2016/17 (ISA 260)* that there were significant difficulties in carrying out the audit work over the Authority’s PPE and investment properties. This difficulty extends to the Authority’s Council Dwellings.

The Authority has so far engaged three external valuers. This is in addition to the initial use of its internal valuation specialists, who have since left the Authority. The external valuation firms are:

- Underwoods;
- Bruton Knowles; and
- GVA

Appendix 3 summarises the key events relating to our work on the Authority’s fixed assets.

Table 1: Use of valuation experts

	Council Dwellings	Other land and buildings	Investment properties
Internal valuers	Full	Part	–
Underwoods	Review	Part	Full
Bruton Knowles	Full	–	–
GVA	–	Part	–

Council dwellings

Background

We reported in our September 2017 report that we had noted issues with the valuation exercise previously undertaken by Underwoods in February 2017. As a result of this, the Authority engaged Bruton Knowles on 20 April 2017 to perform the valuation exercise on beacon properties which had been previously valued by the internal valuers and reviewed by Underwoods.

Bruton Knowles reports, May and September 2017

We undertook a review of the initial Bruton Knowles report (dated May 2017), which we received on 23 June 2017. We noted a number of issues with the report:

- the valuer had adopted a social housing adjustment factor of 33%, which is not consistent

with the guidelines issued by the Ministry of Housing, Communities & Local Government (MHCLG, previously DCLG). This was the social housing adjustment factor for the South East; and

- a full valuation had not been undertaken on the chosen beacons per the Authority’s instructions. This was not in line with the requirements.

Table 2: Social housing adjustment factor – MHCLG guidance

	Previous guidance (Jan 2011)	Update guidance (Nov 2016)
East Midlands	34%	42%
South East	32%	33%

Our valuation specialist has reviewed the valuation report and liaised with Bruton Knowles to understand and review the valuation basis, methodology, and assumptions used in the valuation exercise. Our specialist had challenged the year-end uplift of 10%, due to reliance on one source of information.

Bruton Knowles subsequently agreed to amend the report to take into account the issues raised by KPMG. A revised report was issued in September 2017. We noted pages missing from the draft report and requested a final version. We did not receive the final report until 28 March 2018.

Reconciliation of valuation report to fixed asset register

Due to the expectation that the Bruton Knowles valuation exercise will change the Authority’s beacon values, we requested in December 2017 that the Authority provide a reconciliation between the draft version of the valuer’s September 2017 report and the fixed asset register. The reconciliation process is important as it provides assurance both to the Authority and auditors that:

- all assets that should be valued have been valued;
- the correct information (asset name, type, value, etc) have been provided to the valuer; and
- the valuer’s valuation has been correctly transacted by the Authority and correctly reflected within the fixed asset register.

As with the first report (May 2017), no reconciliation

had been provided to us (despite multiple requests dating back to December 2017). We reiterated this on 1 February 2018 that this is crucial to progressing with the audit. A working paper was subsequently provided on 12 April 2018. We reviewed this working paper and found differences between the previous year's closing figures and the figures used by Bruton Knowles.

Application of uplift based on original valuation

Upon investigation, the Council informed us that this was due to the uplift of 4.08% which had been applied by the internal valuers on 1 April 2016—this was the original valuation which has since been superseded by both the Underwoods and Bruton Knowles valuations.

It was unclear why this original uplift had been transacted given:

- Underwoods had found issues with the original beacons (although Underwoods' report has been challenged by us); and
- Bruton Knowles subsequently found issues with the valuation and the results materially differ from the internal valuer's original valuation.

This would typically not be an issue given the valuation should always reflect the balance sheet date. However, this 4.08% was applied to the 80% of beacons not valued by Bruton Knowles. This transaction has the effect of reflecting the internal valuer's assumptions and methodology—which have been challenged and superseded by Bruton Knowles. The calculation of the 4.08% uplift is based on the average valuation movement on the original sample of beacons revalued by the Authority's internal valuers.

We were also not made aware that the internal valuation had been transacted.

The Authority has informed us that the Bruton Knowles valuation as of 1 April 2016 was effectively ignored due to the overall impact being "relatively small". To illustrate, Table 3 summarises the values from the May 2017 Bruton Knowles report and the internal valuer's report. Both retain the incorrect social housing adjustment factor to aid comparison.

Table 3: Comparison of valuation results, 1 April 2016

£'000	Internal valuers	Bruton Knowles	Difference
Valuation (social housing)	89,845	83,652	6,193

A difference of £6.2 million is material for the purposes of the Authority's accounts.

Further use of the incorrect social housing adjustment factor

We were not initially provided with a copy of the internal valuer's report due to this valuation exercise being undertaken by the Authority's external valuers; we requested this on 20 April 2018. Upon receipt of the report on 30 April 2018, we reviewed and noted—again—that an incorrect social housing adjustment factor of 34% had been used. This was the social housing adjustment factor in the previous version of the guidance. The new guidance was released in November 2016 and applicable to valuations from 1 April 2016 onwards (see Table 2 on the previous page).

The use of 34% instead of 42% by the internal valuers is a material difference.

The reliance of the internal valuation is also an issue due to the same uplift calculated from the internal valuer's valuation, which as previously discussed, had been superseded by the Bruton Knowles valuation.

Our line of inquiry has also uncovered that whilst Bruton Knowles had adjusted for the correct social housing adjustment factor for its valuation as at 31 March 2017, this was not adjusted for its 1 April 2016 valuation. This is crucial as the valuation at the year end is a simple uplift of 7% on the 1 April 2016 figures, thus carrying forward the initial error.

We expect a significant audit adjustment to arise from this. The Authority is in the process of calculating and quantifying this difference.

Resolution

The Authority has again commissioned Bruton Knowles to carry out a further valuation exercise for the valuation figures as at 1 April 2016 (due to the derivative nature of the year-end valuation).

We will review:

- the valuation instructions provided to Bruton Knowles, for the valuation as at 1 April 2016;
- the valuation report resulting from these updated instructions; and
- an updated reconciliation between the final valuation report and the fixed asset register.

We do not anticipate engaging the services of our KPMG valuation specialist; however, this may change depending on the outcome of this valuation exercise.

We will also need to reperform work previously undertaken due to the updated report, including but not limited to:

- reviewing the list of assets to be valued (the input) against the Authority's records. This is to ensure compliance with the Code's requirement that assets should be valued at intervals of not more than five years and against the Authority's own policy of a rolling valuation basis;
- we will also need to recheck that the assets' characteristics (value, type, etc) have been accurately provided to the valuer;
- reviewing completeness of the valuer's output; where there have been asset disposals, these will need to be agreed to the work previously undertaken;
- reviewing the reconciliation to be provided by the Authority; and
- reviewing the mathematical accuracy of the report.

Appendix 2 summarises the Council Dwellings valuation requirements and the various reports received.

Other land and buildings

Underwoods

Our KPMG valuation specialist had raised a number of queries in relation to the assumptions used by Underwoods due to the absence of documented information within the reports. These were finally resolved in October 2017.

Further work was undertaken to clarify and agree

specifics of the sampled assets, such as deeds and titles.

An adjustment that resulted from our valuer's review relates to purchaser's costs, which have not been consistently deducted from the assets reviewed in our sample. This adjustment has reduced the value of the Authority's assets by approximately £748,000, which is above our reporting threshold.

The work had also resulted in various other adjustments, including reclassification of assets from other land and buildings to investment properties.

Internal valuers

Investment properties

The Authority engaged Underwoods to value its portfolio of investment properties.

We were provided with two valuation reports:

- the first on 17 July 2017, which totalled £7.7 million. This did not match the Authority's draft financial statements (June 2017), which valued investment properties at £8.1 million—a difference of £0.4 million. We undertook our initial work on investment properties, and identified issues. This initial work was completed on 24 July 2017, and was based on this first version of the valuation report; and
- the second on 24 July 2017, which totalled £8.3 million.

Due to the differences (as noted above), we requested on 4 October 2017 that the Authority clarify and identify the correct report. We received a full explanation on 24 October 2017, which explained that the original value in the July 2017 accounts was incorrect, and the value per the valuation report dated 26 July 2017 was correct due to a reclassification of an asset into investment properties.

As with other land and buildings, our KPMG valuation specialist identified that Underwoods had not deducted purchaser's costs from the valuation of assets, thus overstating the Authority's investment properties.

We had low confidence on the robustness of the valuation process due to the issues of purchaser's costs, misclassification of assets, data quality, and

the difficulty in evidencing assumptions made by the valuer. As a result, we extended our sample to encompass 100% of all investment properties on the Authority's portfolio on 6 December 2017. Our KPMG valuation specialist undertook this work in December 2017.

PPE assurance committee

Due to the various issues noted with PPE and investment properties as well as the incomplete responses received to our initial PPE queries, the Authority had put in place a "PPE task force" which was operational in October to November to check its responses to audit queries and ensure quality. Despite this, we still encountered issues which prolonged the audit process.

Trial balance reconciliation

We requested a trial balance reconciliation as part of our initial audit documentation request. This has historically not been provided to the audit team. A workaround is typically used, where the trial balance is reconciled piecemeal per section, as each working paper typically contains an extract of the trial balance.

However in January 2018, there were concerns that the trial balance may not have been appropriately mapped due to recharges.

We formally re-requested a reconciliation between the trial balance and the Authority's draft financial statements on 23 February 2018. We received a working paper on 26 April 2018; however, we had a number of queries in relation to this. This is now being reviewed by our accounting technical advisors.

Other completion work

A number of audit procedures will need to be re-performed due to the significant changes. These include the following areas:

- the cash flow statement;
- the depreciation substantive analytical procedure;
- the impact of revaluations/impairments on the CIES and reserves; and
- quantifying a full list of audit adjustments.

We have yet to begin work on the consolidation of the Authority's group accounts; this will take place

once the Authority's single-entity accounts have been finalised.

Our work will also need to undergo our usual review process, which could not have been undertaken due to the evolving nature of the Authority's accounts.

A full list of adjustments will be presented to the Audit Committee upon completion of our work.

Update on the audit fees

We stated during the Audit Committee on 27 September 2017 that the additional cost in relation to the additional work and ongoing delays to the audit was likely to be £71,250. This was discussed with the former Chief Finance Officer (S151 Officer) and subject to PSAA approval.

Eight months have passed since that initial estimate. Due to the planned nature of our approach to scheduled audits, the additional responsive work which we had to undertake was predominantly fulfilled by senior staff. We also had to engage additional services from our KPMG valuation specialist due to the issues found and the lack of readily-available evidence to support the valuations.

This highlights the importance of robust management review and the provision of clear audit working papers within the agreed timeframes.

We will be discussing our final proposed fee with the Authority's Chief Finance Officer which will reflect the additional amount of work needed to gain assurance over your financial statements.

2017/18 audit

As the audit of the 2016/17 financial statements is on-going, we are yet to issue our 2017/18 audit plan. We have commenced our planning work in relation to 2017/18 and have held discussions with the Authority regarding the appropriate timing of the audit. We will issue an audit plan and update the Audit Committee ahead of any fieldwork.



Appendix 1

External audit letter, September 2017



KPMG LLP
Infrastructure, Government & Healthcare
One Snow Hill
Snow Hill Queensway
Birmingham B4 6GH
United Kingdom

Tel +44 (0) 121 232 3869
andrew.cardoza@kpmg.co.uk

Private & confidential

Mr G Hammons
Section 151 Officer
The Guildhall
St. Giles Square
Northampton
NN1 1DE

Our ref DH/AC/NBC

Contact Daniel Hayward
 0121 232 3280

29 September 2017

Dear Glenn,

Northampton Borough Council – 2016/17 External Audit progress

Following the Audit Committee on Wednesday 27 September 2017 I am writing to you to provide an update regarding the status of our audit.

At the Audit Committee I had highlighted the potential risk that the audit may not be completed and the audit opinion issued before 30 September. Unfortunately as I have discussed with you this risk looks likely to be realised, and I know you share my disappointment in this situation. My team and I, as well as your team, have worked tirelessly to try avoid this situation, however, and again as discussed I am of the view that we have not as yet performed sufficient testing nor obtained sufficient evidence to enable me to issue an opinion.

As you are aware and as noted at the Audit Committee, and as per previous discussions with yourself, other Officers and Members at the time, our work to that point had identified a significant number of issues relating to the Authority's fixed assets, including but not limited to the valuation of social housing, other land and buildings, and investment properties, as well as the methodology adopted towards componentisation.

Whilst significant work has been undertaken by both my audit team and your Closedown team in order to respond to and address these issues, the result of our findings so far has provided me with insufficient assurance that your financial statements present a true and fair view in this respect and many of these issues remain unresolved.

Due to the number of areas of concern and errors found during KPMG's valuer's review of a sample of assets, my consideration in consultation with KPMG colleagues is that resolution of these specific issues currently would not provide sufficient audit assurance that the remaining population of assets, not sampled, are appropriately valued. Therefore there remains a risk of possible material misstatement.

Given the issues identified, and unanswered questions remaining around the reporting from the fixed asset system, this also brings into question the accuracy of those assets which have not been revalued in the year, transactions processed during the period and the accuracy of overall reporting and disclosures in this respect.

As you will no doubt appreciate the responsibility for ensuring that a materially correct set of accounts is presented for audit lies first and foremost with you as the section 151 officer. At this stage we think that there is still an uncertainty surrounding the robustness of the valuation that would enable you to be able to discharge your statutory responsibilities.

It may be very likely that there is no change in the values in the accounts, I certainly hope that is the case. However, we will only be able to judge this when we have completed our testing and evaluated the evidence.

We are hoping to complete the audit as quickly as possible and I am aware that my team is in discussion with your team on what testing we still need to complete and what evidence that needs to be collected. Whilst we need to do this as quickly as possible I also am conscious that we need to avoid the situation of information being given to us in haste that raises further questions that often take longer to clear. We will be working with your team to try and avoid this situation.

If you have any questions please do not hesitate to contact me.

Yours sincerely



Andrew Cardoza
Director, KPMG LLP

cc: Northampton Borough Council Audit Committee



Appendix 2

Council Dwellings revaluation requirements

Council Dwellings revaluation requirements

The Code requires the Authority to value Council Dwellings in line with the requirements of the MHCLG’s Stock Valuation for Resource Accounting (SVRA), updated November 2016.

The Code guidance states:

C50: It is common practice for valuations in local government to be made as at 1 April. However, the general requirement to ensure that transactions and balances are not materially misstated might make necessary a valuation as at some other date. The historical experience of 2008/09, when there was a substantial slump in the property market during the year, shows that 1 April valuations cannot always be relied on when preparing the 31 March Balance Sheet.

What this means in practice is that there are two valuation exercises in year:

— **The first full valuation at the start of the financial year (dated 1 April).** This is carried out in accordance with the MHCLG’s SVRA. Northampton Borough Council has opted to value 20% of its housing stock on a rolling basis, using the beacon methodology. The valuation of the remaining 80% is then informed by the results of the full valuation on the 20% of beacons. This is in line with the SVRA.

— **An impairment review or an indexation, depending on the market and valuer’s professional judgement.** This is often linked to housing indices published by leading building societies, the Land Registry, and other industry sources. This is tailored to local circumstances where appropriate using the valuer’s professional judgement.

Each of the valuation exercises is then discounted using the social housing adjustment factor to arrive at the Existing Use Value – Social Housing (EUV-SH). This factor is applied to both the 1 April and 31 March valuations.

Summary of Council Dwellings valuation

In order to summarise the valuation reports to date, we have adopted the referencing convention in Table 4 below. Overleaf in Table 5, we have summarised the work on each valuation report and our findings. Note that this ignores the valuation exercise from Underwoods as it was deemed non-compliant. Table 4 also summarises the valuation dates.

Table 4: Council Dwellings valuation reports

Valuer	Ref	Valuation date	Adjustment factor	Full/indexation	Date of report
Internal	VAL1	1 April 2016	34%	Full	Not dated, pre October 2016
Internal	VAL2	31 March 2017	N/A – not available	N/A – not available	N/A – not available
Bruton Knowles	VAL3	1 April 2016	33%	Desktop	} 31 May 2017
Bruton Knowles	VAL4	31 March 2017	33%	Indexation – 10%	
Bruton Knowles	VAL5	1 April 2016	33%	Full	} 22 September 2017
Bruton Knowles	VAL6	31 March 2017	42%	Indexation – 7%	
Bruton Knowles	VAL7	1 April 2016	42%	Full	} Pending as at the time of writing
Bruton Knowles	VAL8	31 March 2017	42%	Indexation – 7%	

Table 5: Summary of review and findings

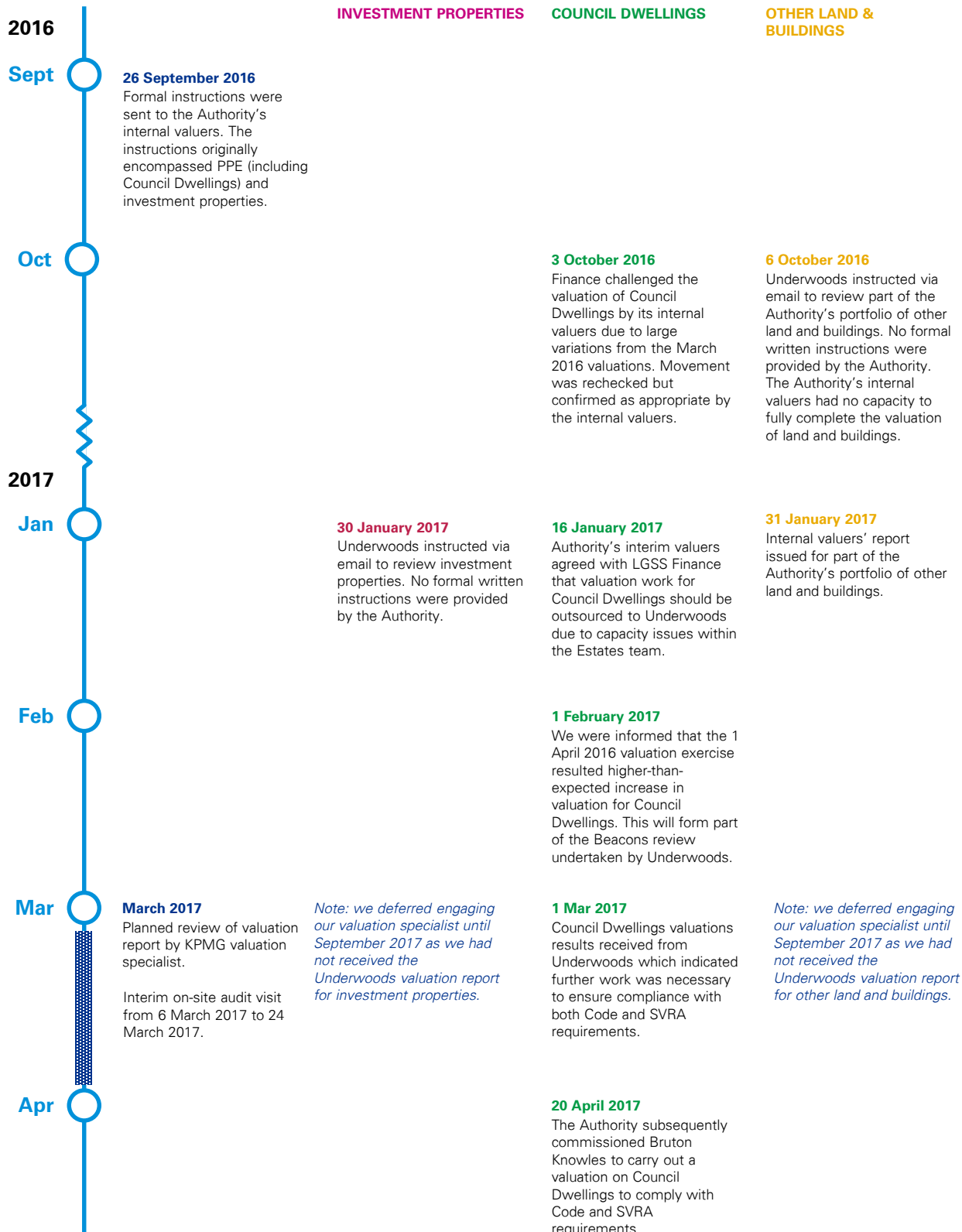
Ref	Valuation date	Summary
VAL1	1 April 2016	Original valuation, which triggered the review from Underwoods and subsequently, Bruton Knowles. Date of the report is not disclosed, but instructions were provided by the Authority in September 2016, and the report was challenged by Finance in October 2016 (see Appendix 3).
VAL2	31 March 2017	N/A – valuation not used due to the valuation process being outsourced and superseded by the Bruton Knowles valuation exercise.
VAL3	1 April 2016	<p>For both VAL3 and VAL 4: We determined that the valuer had used 33% for the social housing adjustment factor for its valuation exercise. This was subsequently revised to 42% which is in line with the guidance (see discussion on page 4 of this report, and within our <i>External Audit Report 2016/17 (ISA 260)</i>.</p> <p>For VAL4: Our KPMG valuation specialist challenged the use of 10% indexation in VAL4 due to dependency on one data source. This was subsequently revised to 7% in VAL6.</p>
VAL4	31 March 2017	
VAL5	1 April 2016	<p>For both VAL5 and VAL6: We requested a reconciliation between this report and the Authority’s fixed asset register. The reconciliation process has shown that VAL5 was not transacted; instead, VAL1 was transacted despite the known issues found by Bruton Knowles. This is now a new audit finding as VAL1 had crucially used an adjustment factor of 34%.</p> <p>Our query has also uncovered that the incorrect adjustment factor as identified in VAL3 and VAL4 was not corrected for VAL5; only VAL6 had the correct adjustment factor. The Authority has since agreed to amend VAL5 and use VAL5 instead of VAL1.</p>
VAL6	31 March 2017	
VAL7	1 April 2016	Both reports are pending as at the time of writing.
VAL8	31 March 2017	



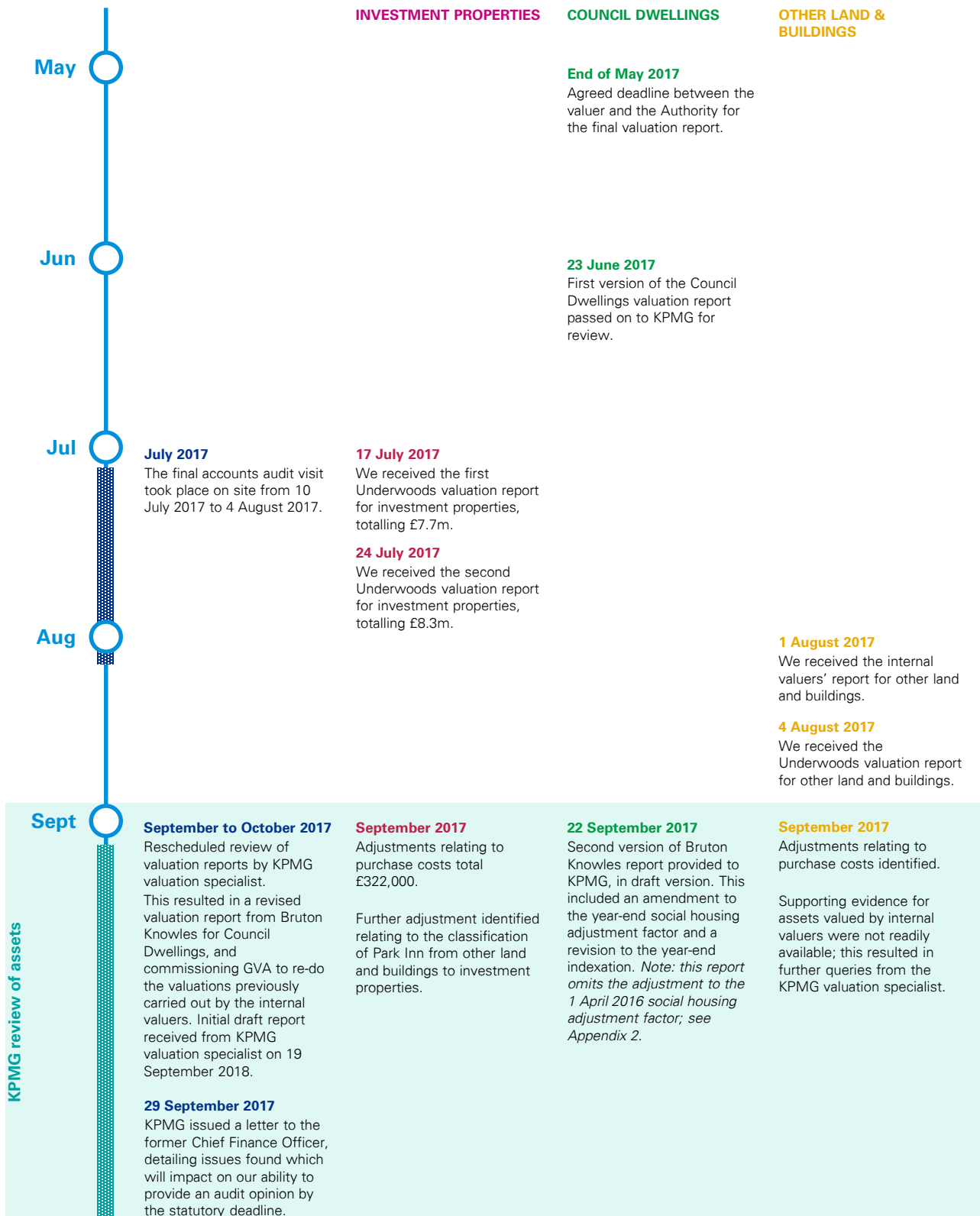
Appendix 3

Timeline of key events relating to PPE and investment properties

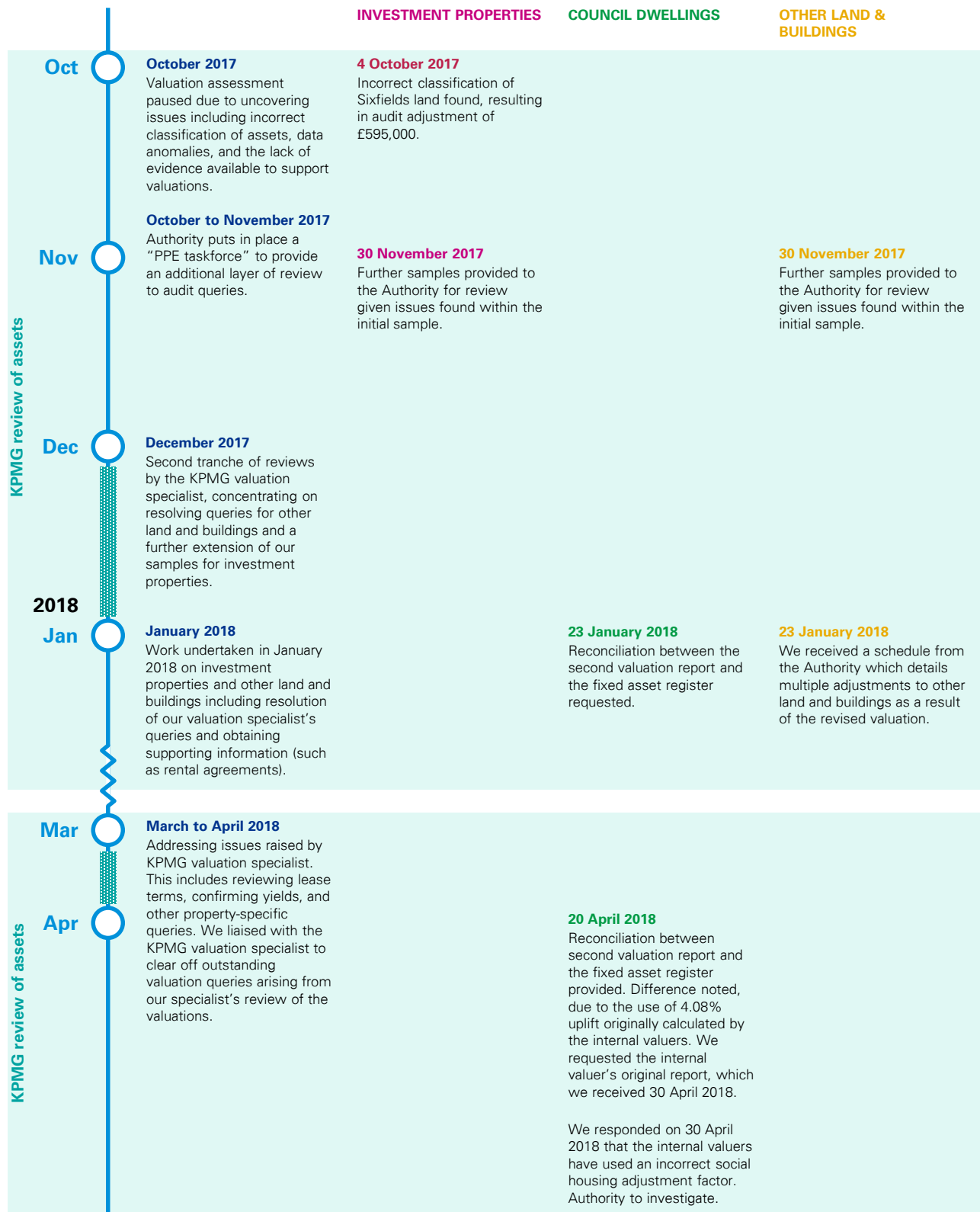
Timeline of key events for PPE & investment properties



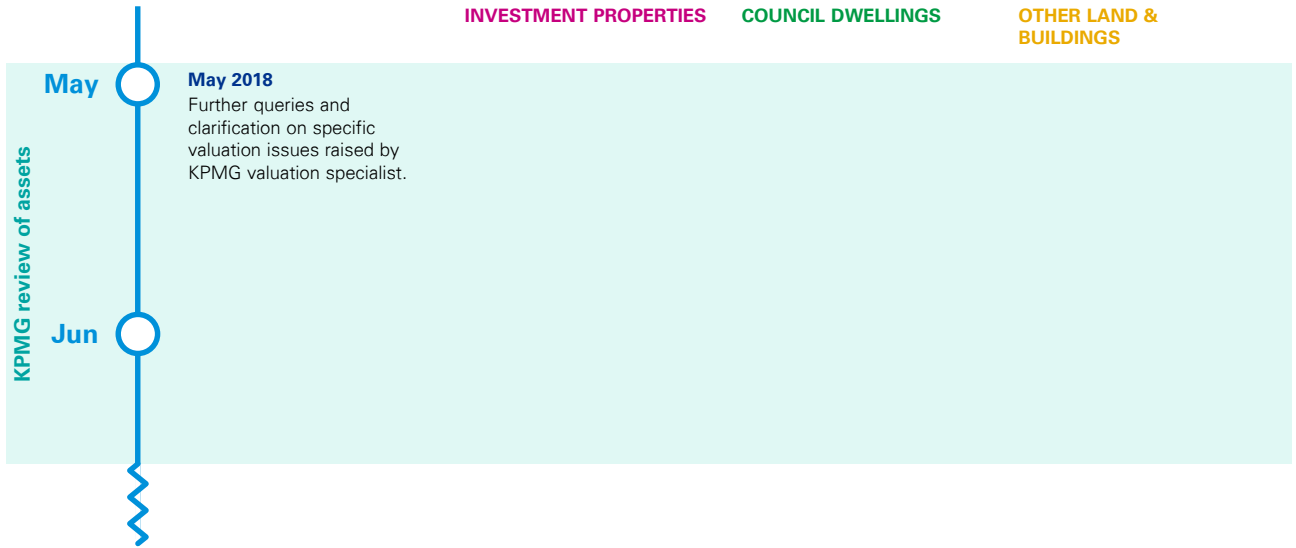
Appendix 3



Appendix 3



Appendix 3





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