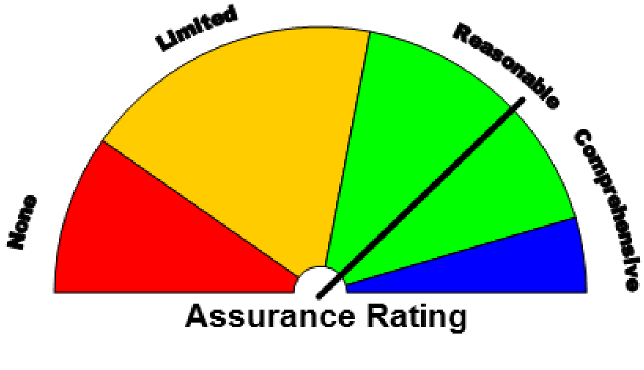
central midlands audit partnership

Derby City Council - S24 Capital Asset Valuations

Final Audit Report



Providing Excellent Audit Services in the Public Sector

February 2019

Our Vision

To bring about improvements in the control, governance and risk management arrangements of our Partners by providing cost effective, high quality internal audit services.

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Providing Excellent Audit Services in the Public Sector

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1 Executive Summary

1.1 Scope of Audit

1.1.1 This audit focused on the commitments made by the Council in response to the External Audit Section 24 letter and tested for confirmation that the actions identified were embedded to avoid the same issues occurring in future.

1.1.2 It should be noted that the work undertaken by Internal Audit has focussed solely on the Section 24 action plan (please see Appendix 1) and the work undertaken as part of that commitment to deliver and embed the actions stipulated in the plan. This internal audit review covered action points relating to Capital Asset Valuations. The results of the outcome of work on Reconciliations, Write-offs and Provisions and Year-end procedures action points have been reported in a separate audit report.

1.2 Summary of Audit Findings

Control Objectives Examined	No of Controls Evaluated	No of Adequate Controls	No of Partial Controls	No of Weak Controls
There would be controls and structures in place to ensure that there are sufficient suitably qualified, experienced and informed staff in place to complete the closedown of accounts exercise.	3	3	0	0
There should be a documented review of the capital information used in the Statement of Accounts.	10	6	1	3
There should be robust controls over the Excel valuation models, the data they contain and the transfer of data from the spreadsheets to the SAM (Estates) and RAM (Finance) systems.	7	3	1	3
TOTALS	**20**	**12**	**2**	**6**

1.2.1 The following issues were considered to be the key control weaknesses:

Rec No	Risk Rating	Summary of Weakness	Agreed Action Date
1	Moderate Risk	There was no evidence that the process of monthly validation of capitalised salaries, introduced in January 2018, included a review of values, to confirm completeness. The year- end certification had been done on lump sum values rather than on a project by project basis, with amounts posted not reconciled to the holding accounts Spreadsheet.	Implemented
2	Low Risk	There was no evidence of reconciliation of eureka fees/salaries capitalised (as noted on general ledger holding codes), to the values posted to the General ledger (capital codes,) on a project by project basis.	Implemented
3	Moderate Risk	Capital transactions were not being processed throughout the year to ensure revaluation and recording routines were embedded. The Capital Accounting RAM system and the general ledger were reconciled only at the year-end when the general ledger was updated via journals.	Implemented
4	Moderate Risk	The value of indexation provided by a professional valuer had not been applied to the assets value. A rationale for not applying indexation has not been provided and the agreement of the external auditors to this could not be demonstrated.	Implemented

5	Low Risk	Guidance and procedural documents were not comprehensive; they did not include the process for transfer of data from the valuations records to the RAM system or reconciliations between the RAM and SAM systems.	31/03/2019
6	Low Risk	The procedures for selecting assets for valuation, notifications to the valuer and checking and recording of the results were not documented.	30/09/2018
7	Low Risk	Dates for completion of asset valuations for 2017/18 noted in the year end plan did not align with the stated intention to complete the exercise by quarter 3, December 2017. The year-end closedown plan included deadline dates in March 2018.	31/12/2018
8	Moderate Risk	Property valuations provided by the valuer were not transcribed accurately to the asset register (RAM system). Componentisation analyses provided by the valuer were not transcribed accurately to the componentisation and depreciation working paper.	31/03/2019

1.2.2 This report focuses on the weaknesses in the Council's systems of control that were highlighted by this audit and recommends what Audit considers to be appropriate control improvements. This report contains eight recommendations, four are considered a low risk and four a moderate risk. There are no significant or critical risks.

All of the issues were accepted. Four recommendations have already been implemented with one due to be implemented by the end of December 2018, two by the end of March 2019 and one by the end of September 2019.

1.3 Summary of Control Assurance Provided

1.3.1 **Reasonable -** We are able to offer reasonable assurance as most of the areas reviewed were found to be adequately controlled. Generally risks were well managed, but some systems required the introduction or improvement of internal controls to ensure the achievement of objectives.

Management and the Audit Committee should note that the following issue(s) will be referred to the Responsible Financial Officer for consideration for inclusion in the Council's Annual Governance Statement:

- The Council's valuer had provided a detailed and reasoned argument for indexation totalling £11.829 million to be applied to the Council's housing stock (£8.022 million) and specialised properties (£3.807 million). The valuer's recommendation was endorsed by a suitably qualified officer of the Council, the Head of Strategic Asset Management and Estates.

  However, the Council's Finance officers have indicated that said indexation will not be applied.

1.4 Distribution & Communication

1.4.1 This draft report was issued to Toni Nash, Head of Finance - Corporate Resources and Jayne Sowerby-Warrington, Head of Strategic Asset Management and Estates for comment.

A final version will be issued to Don McLure, Interim Strategic Director of Corporate Resources with a copy to:

- Toni Nash, Head of Finance – Corporate Resources
- Jayne Sowerby-Warrington, Head of Strategic Asset Management and Estates

This report was produced by Steve Sheppard, Senior Auditor and reviewed by Lynne Parkin, Interim Assistant Audit Manager and Jacinta Fru, Audit Manager. Any enquiry concerning the content of this report or associated issues may be made to Steve Sheppard, Senior Auditor on ext. 64 1998.

2 Positive Assurance

We attempted to establish whether the Council's system of control for the following areas contained all the key controls expected of a sound and robust process. Through a combination of control evaluation and testing we confirmed that the following adequate controls were in operation:

2.1 Staffing

The Section 24 Action plan identified that a robust review and challenge of valuations had been difficult to achieve due to there having been several changes made to staffing within the Council's Estates team since late 2015 in an attempt to address issues around the lack of dual sign-off for major asset valuations, the lack of peer review of valuations from a suitably qualified and experienced individual, and the lack of in-house experience of more technical aspects of asset valuation. A stable robust staffing structure needed to be created and maintained within the Council's Estates team, supported, as deemed necessary, by the use of outside expertise. (Action point A4)

In response, the Council noted that

- *sufficient resource would be made available to ensure that the Estates team would be effectively supported by external expertise with the relevant technical knowledge.*
- *The current Estates team had worked hard to support the revised valuation process and were now deemed to be fit for purpose.*
- *Lessons had been learnt and the Estates Team would, in future, be more closely engaged within the planning process and timetables of the finance team and would be involved in training and awareness of any changed reporting requirements*. (See para 3.2.4 below re: Involvement of Estates Team in the planning process)

- We observed that the staffing in the Estates Team had undergone review following the experiences of the previous two years; areas of concern had been identified and action taken to resolve those concerns. Recruitment to two senior positions in the Estates Team was completed in 2017. The person specifications that applied to the positions required that the post holders must be a full member of the Royal Institution of Chartered Surveyors with Post Qualification Experience and a member of the RICS Registered Valuer scheme. Qualifications were checked during a robust recruitment process.

  We confirmed that there was now a stable Estates Team in place, defined by the management structure chart. All posts had been filled. There were no vacancies at the time of the review.

  We also observed that the Council's Estates Team was supplemented for the valuation of properties by a contractual arrangement with a professional valuations organisation. The contractual obligations required that the Council were supported by dedicated staff that were suitably qualified.

  We were also made aware through discussion with the officers in the Estates Team (including the Head of Service) that in the absence of a member of the Estates Team, other officers with equal qualification were available to take over the tasks. The post holders of the Estates Manager and Principal Asset Valuer positions could interchange, if necessary, and could also deputise for the Head of Service.

2.2 Review of Asset Information

The Section 24 action plan identified that the Council obtained significant amounts of data to support the asset valuations made. However, the source of the data was not always clear, and the analysis of the data and how it had been applied to the resultant valuation was not clearly documented. There was a tendency to list comparable data without analysis as to the context and asset in question. With so many assets in a similar geographic area, often a single list was applied to multiple assets without application to the specific asset in question. This meant that asset valuations were difficult to review and challenge. (Action point A3)

In response, it was noted that the development of clear working paper standards was in progress and was to be tested during the production of the 2016/17 statement of accounts.

- We observed that standardised formats were being used in communications between the two departments that contribute to the correct valuation and representation of capital assets in the financial statements.

  We also found that the methods of communicating asset valuations from the Valuer to the Council was undertaken using a standard reporting format.

The Section 24 Action plan identified that a robust process was not in place to ensure that significant events giving rise to impairment or other significant change in valuation were appropriately considered in the valuation of property assets. This meant that valuations were not updated on a timely basis to reflect significant events impacting on the valuation of assets.

In response, it was noted that the Estates team would prepare a half yearly report confirming the property portfolio and all significant changes and events which was reconciled to the asset register. *(Action point A5)*

- We found that a review of impairments had been completed and reported on by the Principal Asset Valuer and the report shared with the Finance team. The report sought to identify those property assets which should be reviewed due to a physical change or occurrence during the financial year.

  The S24 Action plan identified that any change in circumstances that could give rise to the life of assets on the register with a 1 year life span should be reflected in the valuation of assets. In response it was agreed that an assessment of asset lives would be completed in 2017/2018 to ensure that depreciation would be fairly stated. *(Action point A6)*

- We observed that the Valuer included an estimation of life expectancy in the valuation reports supplied. This had identified a number of discrepancies between the current and a previous estimate. The Valuer's findings prompted a desk top review of other assets, primarily schools. We have reviewed valuation reports, the Valuer's returns and the desk top review of schools valuations and asset lives and can confirm that asset lives were included therein.

  The Section 24 Action plan identified that a significant proportion of Property, Plant and Equipment (PPE) additions related to Eureka fees, effectively the capitalisation of management time to projects. The rates used were not formally approved. (Action point A7)

  In response, it was agreed by the Council that a review of the process, scope and control of the capitalisation of internal costs would be undertaken to develop a more structured and transparent policy.

- We found that the action plan had been implemented. Capitalisation rates had been included in a procedure and policy which had been approved by the Strategic Asset Management Board.

  We found that the Council's Capitalised Salaries Policy had been reissued in November 2017. A review of the policy confirmed that it provided clear guidance on the capitalisation of salary costs incurred when new assets were developed and constructed. The following elements were included in the policy:

  - An acknowledgement that the policy considered CIPFA guidance.
  - The rules for capitalising salary costs or treating as revenue expenditure.
  - Specific rules for capitalising salary costs when developing an IT application.
  - Use of a spreadsheet based system to calculate capitalised values, based on actual costs plus, in some instances, a percentage for on-costs
  - The rates to be applied when capitalising salary costs.
  - The process for monitoring and authorising capitalised salary costs
  - Example standard documents to be used for seeking authorisations.

  In response to the Section 24 Action Plan it was also agreed by the Council that there should be evidence of review and approval by the Service Directors for the amount of capitalized spend at the end of each financial year.

  We found that the action plan had been implemented. Two certifications had been completed for the year end capitalised salaries values, from Communities and Place and from ICT. Both certifications carried the signature of a Strategic Director or interim Director.

  The Section 24 Action plan identified that descriptions of assets were not clear due to historical capturing of capital expenditure; the Council should ensure that all capital expenditure was appropriately described in the asset register, and matched to the relevant existing assets, where applicable. (Action point A11)

  In response the Council agreed that there were weaknesses in the financial accounting and monitoring processes regarding the identification and recording of capital expenditure. Planned changes in the structure and focus of the finance team would support the resolution of this matter and progress would be monitored to ensure the improvement was delivered.

- We found that all new assets were given a Unique Property Reference Number (UPRN). All expenditure was coded to the relevant asset under construction. A review had been completed by the Principal Accountant – Corporate.

  The capital programme was examined and UPRNs were identified for each asset and there was evidence that non - enhancing expenditure had been taken out of capital expenditure and was transferred to revenue expenditure. The use of UPRNs facilitated allocation of capital expenditure to specific assets.

In addition, the Principal Asset Valuer in the Estates team had produced an Impairment and Enhancement Review report for 2017/2018 that identified all capital expenditure on property assets. The value of capital expenditure on each property asset was reported separately by UPRN and asset reference number in the appendix to the report.

2.3 Valuations

The Section 24 action plan identified that the robust review and challenge of valuations had been difficult for the Authority to achieve. The auditor recommended that a stable, robust staffing structure needed to be created and maintained within the Council's Estates team, supported, as deemed necessary, by the use of outside expertise.(Action point A5)

In response the Council agreed to formally contract the services of an independent expert to support the internal process.

- We established that a competitive tender process had been completed to appoint a qualified valuation service; property asset valuations were now undertaken on behalf of the Council by qualified officers engaged through a valuation service.

  The Section 24 Action Plan identified that all valuations were performed manually using Microsoft Excel. Data was then manually entered into the SAM/RAM systems. The use of Excel spreadsheets to calculate valuations and the manual transfer of data from the spreadsheets to the SAM/RAM systems increased the risk of calculation errors occurring through accidental amendments to spreadsheet formulae and data loss or error on manual transfer from Excel to SAM/RAM. Evidence of poor control over the valuation models had been observed which had led to errors and inconsistency of approach. The Council was guided to put in place robust controls over the data within the Excel valuation models and the transfer of such data to the SAM/RAM systems. (Action point A2)

  In response, it was noted that the relevant spreadsheet model would be reviewed to ensure it was supported by appropriate documentation which described its operation and to determine whether control totals could be built in to sense check data entry.

- We confirmed that property valuations provided by the Council's appointed valuer were supported by appropriate documentation that would facilitate accurate maintenance of valuations.

  We also found that the valuations compilation spreadsheet and valuations reports for individual assets were made accessible only to a limited number of officers who needed such access by storing them on drives with limited access. The spreadsheet was also locked to prevent further editing once it had been completed. It was held for reference on a network drive with access limited to finance and estates officers.

- For a sample of 20 valuations we confirmed that the valuations were completed fully and had been signed by the person valuing the property and by a second person who had checked the findings. We noted that the valuations included a breakdown between land and buildings and that in line with the Council's policy, where the total buildings value exceeded £2 million a further componentisation of the buildings value was done, splitting the value into buildings element, services element and external works element

3 Control Weaknesses & Recommendations

3.1 Review of Asset Information

3.1.1 We expected that the Finance Team would have been involved in the recognition and calculation of project management costs.

The Section 24 Action plan identified that a significant proportion of PPE additions related to "Eureka fees", effectively the capitalisation of management time to projects. The rates used were not formally approved and the amounts logged in the spreadsheet for eureka fees did not reconcile to the general ledger. Capitalisation rates should receive formal approval and there should be evidence of review and approval by the Service Directors for the amount of capitalized spend at the end of each financial year. (Action Point A7)

In response, the Council noted that the capitalisation of "internal" project management costs should be reviewed on a project by project basis to ensure the appropriate charges are reflected in both revenue and capital costs and that a review of the process, scope and control of the capitalisation of internal costs would be undertaken to develop a more structured and transparent policy and appropriate working papers prepared to evidence management review and approval. (See 2.2 above re: Capitalisation of salaries Policy)

We found that this action had been implemented partially. There was evidence of review by Accountants of the capitalised amounts in January 2018 and at the financial year-end. We noted, however, that embeddedness could not be demonstrated because the month end reviews had not been completed prior to January 2018. An intention to complete this task monthly in future has been stated. We also noted that the January month end certification did not mention any values; the certification was merely a statement to confirm that certain tasks had been completed to validate the capitalised amounts.

Certification of the capitalised salaries had taken place for the year-end values and had been provided by the Group Accountant (Capital). We noted, however, that the certifications made available to audit were lower in total value than the reported capitalised amount of £4.028 million. Certifications were provided for only £3.415 million, a shortfall of £0.613 million. Further probing revealed

- £550 k as additional external fees for surveyors and architects that would have been coded to the same detail codes as internal fees and which would be checked by the capital accountants when checking total spend on capital schemes.
- £63 k remained uncertified; the Group Accountant, Communities & Place, explained that this was essentially an uncertified amount that was not considered material. Following consultation with the Group Accountant (Capital) and the Group Accountant, Communities & Place we established that both were happy with the capitalisation of this value.
- We also noted that the values of salary recharges and professional fees had been certified en-bloc rather than on a project by project basis.

Failure to include values in monthly validation certifications during the year exposes the financial data to risks of inaccuracy; it also increases the burden of potential investigations into inaccuracies at the year end.

Failure to validate capitalised salaries fully, on a project by project basis and in total, exposes the financial statements to potential inaccuracy and for revenue expenditure to be wrongly classified as capital expenditure.

Recommendation 1	Summary Response
Risk Rating: Moderate Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: There was no evidence that the process of monthly validation of capitalised salaries, introduced in January 2018, included a review of values, to confirm completeness. The year- end certification had been done on lump sums values rather than on a project by project basis, with amounts posted not reconciled to the holding accounts	**Issue Accepted**

Spreadsheet. **Suggested Actions:** We recommend that the monthly validations of capitalised salaries should be extended to include the recorded values, to ensure that accuracy is assured on an ongoing basis, rather than just at year-ends. We also recommend that certifications of the year end capitalised salary values should be fully documented and any errors should be rectified. We further recommend that monthly and annual certifications should be on a project by project basis, rather than by en-bloc reporting.	**Original Response:** "This is sent out to Accountants and Service Managers on a monthly basis to sign off they agree or disagree that the person has been charged at the correct rates to the relevant capital scheme. Any adjustments needed are processed by the service capital accountants. We are performing a quarterly reconciliation to ensure that capital salaries are charged correctly. The process is fully documented, there is a policy document and the monthly sign off sheets as described above." **Post Audit Response:** We were provided with evidence that there is a quarterly sign off of the capitalised salaries for the period. This included the amount for the period and signed confirmation by the relevant Principal Accountant that the rates used were correct. Although the year-end certification was on a lump sum basis we accept that the project by project proposal was made by the interim Director of Finance and was not a requirement of External Audit. **Implementation Date:** Implemented

3.1.2 We expected that to ensure eureka fees expenditure are correctly uploaded to the General ledger as capitalised salaries, there would have been reconciliation between postings to the G/L capital codes and the details of expenditure within holding codes, for individual projects as noted on the Eureka Fees – holding accounts Spreadsheet.

The Section 24 Action plan identified that a significant proportion of PPE additions related to "Eureka fees", effectively the capitalisation of management time to projects. The rates used were not formally approved and the amounts logged in the spreadsheet for eureka fees did not reconcile to the general ledger. Capitalisation rates should receive formal approval and there should be evidence of review and approval by the Service Directors for the amount of capitalized spend at the end of each financial year. (Action point A7)

In response, the Council noted that the capitalisation of "internal" project management costs should be reviewed on a project by project basis to ensure the appropriate charges are reflected in both revenue and capital costs and that a review of the process, scope and control of the capitalisation of internal costs would be undertaken to develop a more structured and transparent policy and appropriate working papers prepared to evidence management review and approval.(See 2.2 above re: Capitalisation of salaries Policy)

We found that the action plan had been implemented partially. We established that the agreed values of capitalised salaries as noted on the GL10-holding accounts spreadsheet had been uploaded to the RAM capital assets register system as additions by the Principal Accountant – Corporate Accountancy. Once this process had been completed, the RAM system was used to generate the journals necessary to facilitate posting as capital items to the general ledger.

Following update of the general ledger, a reconciliation was performed between the value of fixed assets/capital items on the General Ledger as a whole and the value of assets on fixed asset register / RAM system. Eureka fees were therefore not the subject of a discrete reconciliation as agreed, but were included in an overall reconciliation.

An absence of reconciliation between the values of agreed Eureka Fees and the postings to the general ledger could lead to errors remaining undetected and result in inaccuracy in the valuation of capital assets in the financial statements.

Recommendation 2	Summary Response
Risk Rating: Low Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: There was no evidence of reconciliation of eureka fees- salaries capitalised (as noted on general ledger holding codes), to the values posted to the General ledger (capital codes,) on a project by project basis.	**Issue Accepted**
Suggested Actions: We recommended that the values of agreed eureka fees as noted on the Spreadsheet (export from holding codes values) are checked and reconciled to the values of salaries capitalised on the general ledger, on a project by project basis.	**Original Response:** "TRAMPS recharges are processed periodically, there is no holding code. This is a time recording system and the output report from TRAMPS is reconciled to the journal as a normal course of operations and informally reconciled. A final year end formal reconciliation is completed and provided to external audit when requested." **Post Audit Response:** A revised format reconciliation had been introduced for 2018/19, following a recommendation from external audit following their review of the 2017/18 accounts. **Implementation Date: Implemented**

3.1.3 We expected that capital transactions would be processed throughout the year to avoid a potential bottle neck of work at year end.

The Section 24 Action plan identified that a reconciliation between the fixed asset register and the general ledger took place only at the year-end. This put significant pressure on the finance team and increased the risk that the Council would be unable to meet the statutory deadline for preparation of its statement of accounts. Management were guided to consider processing asset addition and disposal transactions throughout the year. (Action point A1)

In response the Council noted that best practice, issued by CIPFA, indicated that balance sheet management was as important as revenue management. The finance team resource direction would be revised to ensure capital monitoring within directorates had equal focus, thereby ensuring that capital expenditure was identified and accounted for on a timelier basis.

In addition future year end planning will seek to accelerate the asset valuation process will be complete by December and capital accounting completed in February in advance of the year end. (See para.3.2.3 re: asset valuation process)

We found that monthly updating of the general ledger had not taken place in 2017/2018. We were informed by the Head of Finance – Corporate Resources that there was no plan to implement the routines to upload information to the system more frequently. Instead, capital expenditure was accumulated in holding accounts and the general ledger was to be updated only at the year-end to reflect transactions that related to capital accounting entries. This extended to amendments to valuations identified by the appointed valuer.

Thus the RAM system was not reconciled monthly or quarterly to the general ledger. The entries in the holding accounts were to be used to produce journal entries that could be uploaded to the general ledger system. Therefore, reconciliation between the General Ledger and the RAM system was not possible at any time other than year ends, when transactions had been completed.

This was contrary to the response made to the S24 audit recommendation which confirmed that there would be regular upload of information throughout the financial year. In view of our finding we were unable to confirm embeddedness of this process.

As noted in the Section 24 report, this puts significant pressure on the limited resource in the finance team to close and reconcile the PPE balances and increases the risk that the Council is unable to meet the statutory deadline for preparation of its statement of accounts.

Recommendation 3	Summary Response
Risk Rating: Moderate Risk	**Responsible Officer:** Nicola Goodacre

Summary of Weakness: Capital transactions were not being processed throughout the year to ensure revaluation and recording routines were embedded. The Capital Accounting RAM system and the general ledger were reconciled only at the year-end when the general ledger was updated via journals.	**Issue Not Accepted**
Suggested Actions: We recommend that as per the Section 24 Action plan, management should process asset addition and disposal transactions throughout the year to enable sufficient time for transactions to be processed and reviewed to ensure quality of financial reporting is maintained. We also recommend that revaluations should be recorded in the Financial Management system as soon as they are advised to the Council, and that journal entries to the general ledger should be completed monthly.	**Original Response:** "The S24 action agreed by the previous S151 officer has been superseded as it was not felt this was the most appropriate solution. However we understand that this was the basis on which the audit was conducted. Because of the nature of capital expenditure and the way in which projects are planned the majority of capital expenditure comes through into the ledger in the latter part of the financial year. Disposals are few in number and are not time consuming at year end. There would little point in placing them in RAM as a disposal value could not be generated until we have the year-end valuation for the particular asset. Revaluations won't be put in the ledger due to the nature of the process because we do not have the information from DVO until the end of the 3rd qtr. This date cannot be brought forward as DVO are trying to give as accurate year end value as possible and they are not permitted to have too greater gap between their valuation and year end." **Post Audit Response:** Accountancy maintains that this is not the most appropriate solution to the issue. The original recommendation from EY was "Management should **consider** processing addition/disposal transactions throughout the year, and undertaking asset valuations at an earlier point to enable sufficient time for transactions to be processed and reviewed to ensure quality of financial reporting is maintained." Internal Audit's opinion is that this has been considered by Accountancy. Therefore the recommendation is implemented. **Implementation Date:** Implemented

3.1.4 We expected that the rationale for the use (or otherwise) of indexation would be fully documented.

The Section 24 Action plan identified that the use of indexation to approximate asset valuation movements was difficult to justify when individual asset valuations were challenged and suggested that indexation should only be used as a tool to revalue assets when the indexation basis can be demonstrated to be directly relevant to the assets to which it was being applied. (Action point A9)

In response, the Council action plan agreed that an appropriate rationale would be provided in order for the basis to be both understood and constructively challenged.

We found that the Council's valuer had provided a detailed and reasoned argument for using indexation to revalue assets totalling £11.829 million. The revalue applied to the Council's housing stock (£8.022 million) and specialised properties (£3.807 million). In line with the S24 action plan requirement, the valuer had demonstrated that the indexation basis used "was directly relevant to the assets to which it was being applied", and the valuer's recommendation had been endorsed by a suitably qualified officer of the Council, the Head of Strategic Asset Management and Estates.

Despite the indexed values in total exceeding the anticipated materiality level set for the accuracy of the financial statements, a decision had been made by the Capital Accountancy Team to exclude this value from the financial statements, citing that an agreement had been reached with the external auditor in 2015/2016 that indexation would not be applied to capital values. No evidence was provided of this agreement and none to confirm that the external auditor had agreed this approach in relation to the 2017/2018 financial statement either. We noted also that the latest available update to the action plan indicated that indexation would not be applied to revaluing of assets, contrary to the S24 recommendation.

We acknowledge from discussions with the Head of Finance - Corporate Resources that CIPFA rules now preclude accountants from arbitrarily computing the indexed values for their fixed assets. This does not however prevent indexed values being reflected in the financial statements where the values have been produced by valuations experts applying a sound rationale, as in this case. In the circumstances it would have been prudent to provide a rationale for not applying the recommended level of indexation, which was material to the financial statements

A failure to apply the indexation values provided may result in an inaccuracy in the financial statements that is greater in value than the materiality levels set for audit purposes.

Recommendation 4	Summary Response
Risk Rating: Moderate Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: The value of indexation provided by a professional valuer had not been applied to the properties' value. A rationale for not applying indexation has not been provided and the agreement of the external auditors to this could not be demonstrated.	**Issue Accepted**
Suggested Actions: We recommend that the recommendations of an expert in the field should be implemented or, if their advice is not followed for financial reporting purposes, a rationale to support this action should be provided and agreed by senior management; agreement of the external auditor should also be sought.	**Original Response:** "It was agreed with EY that Accountants would not apply indexation to assets whether or not provided by a relevant professional. The only exception to the above is Housing stock which was agreed with EY and provided by the DVO. Again the S24 action was inappropriate and could not be actioned – appropriate officers should have been consulted prior to its agreement to outline the detail and issues." **Post Audit Response:** Accountancy provided a copy of the 2017-18 Housing Stock movement tracking schedule that included the adjusted total value of housing stock from the Valuers report. **Implementation Date:** Implemented – Issue was addressed through agreement with EY that the Council was not doing ondexation.

3.2 Valuations

3.2.1 We expected that there would be procedure notes available that described the operation of the valuation model and the interface with the SAM and RAM systems.

The Section 24 Action plan identified that the Council obtained significant amounts of data to support the asset valuations made. However, the source of the data was not always clear, and the analysis of the data and how it had been applied to the resultant valuation was not clearly documented. (Action point A3)

In response, the Council noted that development of clear working paper standards was in progress and would be tested during the production of the 2016/17 statement of accounts.

We established that the Council's procedures for valuations were included in the Invitation to Tender issued to the appointed valuer (and others). We confirmed that the Council had policies on Capitalisation, including salaries, impairments, indexation and component accounting.

We could however, not locate procedures that describe the processes for:

- transcribing valuations completed by the Valuer, to the RAM system, which is the Council's primary record for high value capital assets and source of finance-based information relating to high value assets.
- reconciliation of numbers of assets in the SAM system, maintained by the Estates Section (used for asset management purposes) and the RAM system maintained by Accountancy, used for asset financial values.

In the absence of detailed guidance there is a risk that expectations may not be implemented fully or correctly, leading to potential inaccuracy in the asset values used in the financial statements.

Recommendation 5	Summary Response
Risk Rating: Low Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: Guidance and procedural documents were not comprehensive; they did not include the process for transfer of data from the valuations records to the RAM system or reconciliations between the RAM and SAM systems.	**Issue Accepted**
Suggested Actions: We recommend that a full suite of procedural documentation should be produced that includes all areas of capital accounting. This should be made available to all relevant officers in both the Finance and the Estates teams.	**Original Response:** "We will review the documentation we do have by 31 March 19 to ensure fit for purpose." **Post Audit Response:** N/A **Implementation Date:** 31/03/2019

3.2.2 We expected that responsibility for the valuation spreadsheet would be clearly defined.

The Section 24 Action plan identified that valuations were performed manually using Microsoft Excel. The data from the Excel spreadsheet was then manually entered into the SAM/RAM systems. The use of Excel spreadsheets to calculate valuations and the manual transfer of data from the spreadsheets to the SAM/RAM systems increased the risk of calculation errors occurring through accidental amendments to spreadsheet formulae and data loss or error on manual transfer from Excel to SAM/RAM. There was evidence of poor control over the valuation models which had led to errors and inconsistency of approach. The Council was guided to put in place robust controls over the data within the Excel valuation models and the transfer of such data to the SAM/RAM systems. (Action point A2)

In response the council noted that the relevant spreadsheet model would be reviewed to ensure it was supported by appropriate documentation which described its operation and to determine whether control totals could be built in to sense check data entry.

We found, in discussion with officers from the Estates and Finance functions that the responsibilities for the various processes within the procedures for obtaining and recording asset valuations were known and could be recited by the officers concerned. However, we were unable to locate a procedural document that confirmed the arrangements that were in place.

An absence of documented procedures renders the procedures to be adopted unclear and could result in aspects of the process being overlooked, ignored or misunderstood.

Recommendation 6	Summary Response
Risk Rating: Low Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: The procedures for selecting assets for valuation, notifications to the valuer and checking and recording of the results were not documented.	**Issue Accepted**

Suggested Actions: We recommend that the procedure for identifying the assets that are to be revalued, obtaining valuations and recording of the valuer's work should be fully documented and issued to all officers involved in the process.	**Original Response:** "Estates Comments: I can confirm that we acknowledge the identified risk, the level of risk and recommendation as set out above. It is recognised that although these specific actions (selecting of assets/notifications to the valuer and checking/recording results) were undertaken as part of the delivery of the 2017-2018 Asset Valuation programme they weren't fully documented as a separate working paper/procedural document/from the outset. The responsible owner will delegate the action to the Principal Asset Valuer/Contract Manager and in accepting this risk and associated recommendations will ensure the following actions are implemented:- • A procedure note will be compiled and included as part of the Valuation Manual for the 2018-2019 Asset Valuation programme. We will aim to achieve this by September 30th 2018. • The procedure note will set out:- o The rationale for how assets will be selected and will clearly state whether they are annual revaluations or form part of the "basket of goods" for the 5 year rolling programme o Who will chose the assets o The process documenting how the external valuer (the DVS) will be instructed and by whom o How the checking and recording of the valuation reports / addition onto OneDrive will be dealt with Bullet points 3 and 4 will are closely correlated to the specification as set out in the contract, entered into with the DVS, with effect from October 2017. The Contract Manager will be responsible for ensuring that the wider members of the team are kept up to date with progress of report delivery on a weekly basis via the implementation of dashboard reporting. Please note, for completeness, this action as outlined above will be incorporated into the Asset Valuation Delivery Plan 2018-2019 and monitored accordingly." **Post Audit Response:** N/A **Implementation Date:** 30/09/2018

3.2.3 We expected that the valuation of assets would be completed by the end of Quarter 3 to reduce the workload at year end.

The Section 24 Action plan identified that no reconciliation between the fixed asset register and the general ledger took place throughout the year – everything was done at the year end. This put significant pressure on the limited resource in the finance team to close and reconcile the PPE balances. This increased the risk that the Council would be unable to meet the statutory deadline for preparation of its statement of accounts. Management was guided to consider processing addition/disposal transactions throughout the year, and undertaking asset valuations at an earlier point to enable sufficient time for transactions to be processed and reviewed to ensure quality of financial reporting is maintained. (Action point A8)

In response, the Council indicated that the asset valuation process would be accelerated in future years with valuations to be completed by December in advance of the year end. In recognition of the fact that the Council did not have the resource and expertise to properly complete asset valuations, it was also agreed that external valuation expertise would be commissioned, to ensure the process is accelerated in future years.

Also, the finance team resource is directed to revenue management but would be revised to ensure capital monitoring within directorates would have equal focus. This would ensure that capital expenditure is identified and accounted for on a more timely basis. (See para 3.1.3 above re: Direction of the Team resource towards capital monitoring to ensure earlier capture of capital expenditure)

We confirmed that a three year valuation service was put in place in September 2017, and the contract stated that "*the valuation date of 31st December 2017 is to be adopted for year 1 and similar shall be adopted for years 2 &3"* . However, from discussions with Estates Team we noted that the valuation programme for 2017/2018 valuation had not been issued to the Valuer until November 2017 and therefore had not been completed by December 2017 as agreed in the contract and in response to the S24 Action plan, for future years.

Review of the year-end closedown plan for 2017/2018 financial statements showed a date of 9th February 2018 by which the valuer should provide valuations to the Council and a date of 2nd March 2018 for the quality checking of valuations and input to the Assets Register.

These dates did not allow for completion of valuations by the end of Quarter 3 as intended by the Council per their response to S24 Action plan.

Delays in finalising asset valuations places significant pressure on the limited resource in the finance team, to close and reconcile the PPE balances and increases the risk that the Council is unable to meet the statutory deadline for preparation of its statement of accounts.

Recommendation 7	Summary Response
Risk Rating: Low Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: Dates for completion of asset valuations for 2017/18 noted in the year end plan did not align with the stated intention to complete the exercise by quarter 3, December 2017. The year-end closedown plan included deadline dates in March 2018.	**Issue Accepted**
Suggested Actions: We recommend that in future year end planning, the asset valuation process should be accelerated for completion by December, with capital accounting completed in February in advance of the year end.	**Original Response:** "The intention was to complete by the 3rd qtr but delays from both DVO and Estates impacted on the timetable. Valuation process and capital processes do not align to achieve a February completion as the Valuation process comes after capital expenditure." **Post Audit Response:** N/A **Implementation Date:** 31/12/2018

3.2.4 We expected that the valuation provided by the Council's valuers would be agreed to the asset register and there would be a clear link to any componentisation.

The Section 24 Action plan identified that assets had multiple lines in the asset register due to componentisation of individual assets. The value was not appropriately apportioned between the various individual line items in the asset register and caused uncertainty as to which assets were included in the valuation. This issue, coupled with weaknesses in the SAM to RAM reconciliations, increased the risk that the valuation of PPE recorded in the financial statements would be materially misstated. The valuation provided by the Council's valuers should be agreed to the total value recorded in the fixed asset register for the particular asset subject to valuation. (Action point A10)

In response the council agreed that where assets had separate components in the asset register, revised valuation estimates would be fully reflected against the entire asset. To enhance the process, and evidence action, a separate working paper would be developed to document componentised assets to demonstrate that valuation estimates have been properly accounted for.

We found that the appointed valuer had provided valuations for a selection of the Council's properties, as required by officers from the Estates and Finance teams.

We were informed by the Head of Strategic Asset Management & Estates that the valuations provided by the valuer had been subjected to review and check in both the Estates and Finance teams. The Estates team's review included a reasonableness test of the values reached, undertaken by a qualified valuer. We confirmed that both teams maintained a record of the checks that had been completed.

We confirmed that the valuations provided on the individual valuation reports had been transcribed accurately to the spreadsheet that was used to inform the Council's asset register, maintained in the RAM system. However, on comparing the values transcribed to the Council's fixed assets valuations register, back to those noted on the individual valuation reports for a sample of 20 entries, we noted seven discrepancies that were not explained.

Four valuations split between land (no depreciation) and buildings (depreciation) in the valuation reports were recorded in the asset register as buildings only, as follows:

- Chapel Street Car Park.

  The valuation report noted a split between land (£512 k) and buildings (£484 k) but the value was combined in the asset register as buildings (£996 k)
- Chapel Street Lancaster Sports Centre

  The valuation report noted a split between land (£164 k) and buildings (£156 k) but the value was combined in the asset register as buildings (£320 k)
- Nottingham Road Cemetery - Store

  The valuation report noted a split between land (£7 k) and buildings (£14.5k) but the value was combined in the asset register as buildings (£21.5k)
- Kedleston Road Training Centre

  The valuation report noted a split between land (£300 k) and buildings (£345 k) but the value was combined in the asset register as buildings (£645 k).

We found three instances where assets that formed part of larger assets were included in the register at nil value, although the valuer had provided a valuation sheet that showed values. These assets had been treated as standalone assets whose values were considered below the de-minimus threshold, not as part of the whole. These values had not been recorded in the fixed assets register, as follows:

- Chapel Street Sub-station (part of Chapel Street Car Park)

  The valuation supplied for this asset included a value of land (£3 k). A nil value was recorded in the asset register.
- Nottingham Road Cemetery – Toilet (part of Nottingham Road Cemetery)

  The valuation supplied for this asset included values for both land (£1 k) and building (£3 k). A nil value was recorded in the asset register.
- Nottingham Road Cemetery - Staff Block (part of Nottingham Road Cemetery)

  The valuation supplied for this asset included values for both land (£1,350) and building (£2,650). A nil value was recorded in the asset register.

We confirmed that the valuations provided included a breakdown of the elements of buildings value (componentisation) whenever the buildings value exceeded £2 million, to accord with Council policy.

However, we observed that for two of our sample, the values were transcribed incorrectly from the valuation report to the componentisation worksheet. The errors did not affect the decisions made with regard to componentisation and depreciation, based on percentage variances.

If valuation and componentisation details are not transcribed accurately to the asset register and the componentisation and depreciation working paper, errors may be inherent in the calculations of depreciation charges and total asset values reported in the Council's financial statements.

Recommendation 8	Summary Response
Risk Rating: Moderate Risk	**Responsible Officer:** Nicola Goodacre
Summary of Weakness: Property valuations provided by the valuer were not transcribed accurately to the asset register (RAM system). Componentisation analyses provided by the valuer were not transcribed accurately to the componentisation and depreciation working paper.	**Issue Accepted**
Suggested Actions: We recommend that a check by a second officer should be introduced to ensure that the valuations and analyses provided by the Council's valuer have been transcribed accurately to the fixed asset register maintained in the RAM system and to the componentisation and depreciation working paper.	**Original Response:** "The limited transcription issue was as a result of the compacted timescales as a result of the delay issue mentioned above. For 18/19 we will split assets by Land and Buildings in accordance with the valuation certificate. The valuation certificates are checked independently but due to expediency some were input as a single figure rather than split in 17/18 Further checks will be implemented during 18/19 to try to eliminate any transposition errors." **Post Audit Response:** N/A **Implementation Date:** 31/03/2019

4 Appendices

4.1 Appendix A

4.1.1 Derby City Council S24 Action Plan in response to the statutory recommendation.

S24 Action Plan.pdf

The central midlands audit partnership was formed to provide shared internal audit services to local authorities in the region. CMAP currently provides audit services to three District Councils, a Unitary Council, a Housing ALMO and a Fire Authority and welcomes further public sector partners or clients from within the region.

CMAP central midlands audit partnership

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