

The Audit Findings for Derby City Council

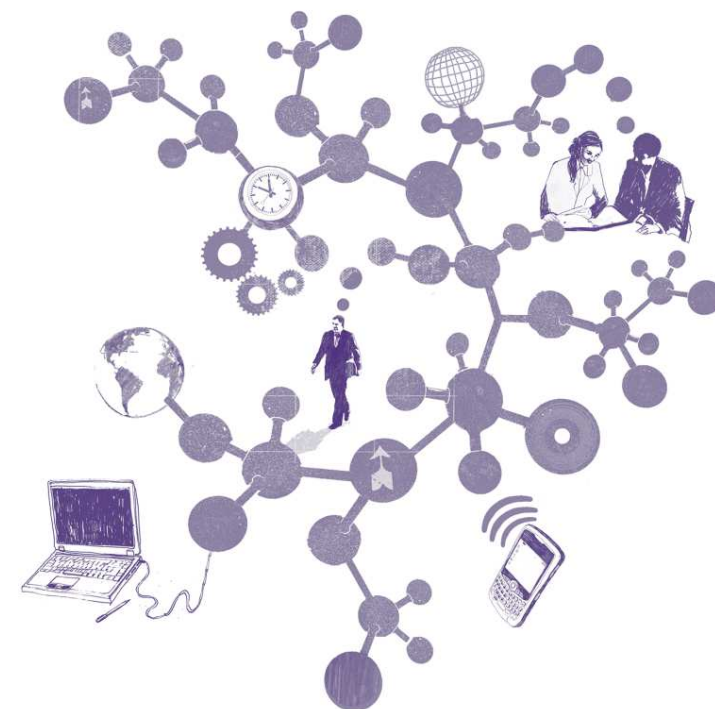
Year ended 31 March 2014

15 September 2014

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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Executive summary

Purpose of this report

This report highlights the key matters arising from our audit of Derby City Council's ('the Council') financial statements for the year ended 31 March 2014. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing 260 (ISA).

Under the Audit Commission's Code of Audit Practice we are required to report whether, in our opinion, the Council's financial statements present a true and fair view of the financial position, its expenditure and income for the year and whether they have been properly prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting. We are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources (the Value for Money conclusion).

Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, which we communicated to you in our Audit Plan dated 12 March 2014.

Our audit is substantially complete although we are finalising our work in the following areas:

- completing our testing of payroll expenditure
- review of the final version of the financial statements
- obtaining and reviewing the final management letter of representation
- review of final version of the Annual Governance Statement

- updating our post balance sheet events review, to the date of signing the opinion and
- Whole of Government Accounts.

We received draft financial statements and accompanying working papers at the start of our audit, in accordance with the agreed timetable.

Key issues arising from our audit

Financial statements opinion

We anticipate providing an unqualified opinion on the financial statements.

We have identified five adjustments affecting the Council's reported financial position (details are recorded in section 2 of this report). The draft financial statements recorded a net surplus of £161,258k; the audited financial statements show a net surplus of £190,230k. Most of this change relates to the audit adjustments for revaluation of property, plant and equipment, the equal pay provision and the Affordable Housing PFI asset impairment.

The key messages arising from our audit of the Council's financial statements are:

- We identified a significant number of audit adjustments during the course of the audit. Management have adjusted the financial statements for all these misstatements.
- We experienced significant delays in obtaining some supporting evidence for our testing.
- We have also identified a number of adjustments to improve the presentation of the financial statements.

Further details are set out in section 2 of this report.

Value for Money conclusion

We are pleased to report that, based on our review of the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources, we propose to give an unqualified VfM conclusion.

Further detail of our work on Value for Money is set out in section 3 of this report.

Whole of Government Accounts (WGA)

We will complete our work in respect of the Whole of Government Accounts in accordance with the national timetable.

Certificate

We are unable to issue the certificate to certify the 2013/14 audit is closed. This is because we are awaiting the outcome of the Council's work to investigate issues relating to failures of governance highlighted in the Council's Annual Governance Statement.

Controls

The Council's management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we report these to the Council.

We draw your attention in particular to control issues identified in relation to:

- payroll expenditure – incomplete information and significant delays in obtaining the requested information
- welfare expenditure – duplicate national insurance numbers
- ICT controls.

Further details are provided within section 2 of this report.

The way forward

Matters arising from the financial statements audit and review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources have been discussed with the Director of Finance and Procurement.

We have made a number of recommendations, which are set out in the action plan in Appendix A. Recommendations have been discussed and agreed with the Director of Finance and Procurement and the finance team.

Acknowledgment

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

Section 2: Audit findings

01. Executive summary

02. Audit findings

03. Value for Money

04. Certifying the audit closed

05. Fees, non audit services and independence

06. Communication of audit matters

Audit findings

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and additional matters that arose during the course of our work. We set out on the following pages the work we have performed and findings arising from our work in respect of the audit risks we identified in our audit plan, presented to the Audit and Accounts Committee on 26 March 2014. We also set out the adjustments to the financial statements arising from our audit work and our findings in respect of internal controls.

Changes to Audit Plan

We have not made any changes to our Audit Plan as previously communicated to you on 26 March 2014.

Audit opinion

We anticipate that we will provide the Council with an unmodified opinion. Our audit opinion is set out in Appendix B.

Audit findings against significant risks

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty" (ISA 315).

In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards.

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
1.	Improper revenue recognition Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition	<ul style="list-style-type: none"> • review and testing of revenue recognition policies • testing of material revenue streams • review of unusual significant transactions 	Our audit work has not identified any issues in respect of revenue recognition.
2.	Management override of controls Under ISA 240 there is a presumed risk of management over-ride of controls	<ul style="list-style-type: none"> • review of accounting estimates, judgements and decisions made by management • testing of journal entries • review of unusual significant transactions 	<p>Our audit work has not identified any evidence of management override of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.</p> <p>We set out later in this section of the report our work and findings on key accounting estimates and judgements.</p>

Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan. Recommendations, together with management responses, are attached at Appendix A.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Operating expenses	Creditors understated or not recorded in the correct period	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> documented our understanding of processes and key controls over the transaction cycle undertaken walkthrough of the key controls to assess whether those controls are designed effectively we carried out detailed substantive testing of expenditure balances included in the financial statements We carried out specific work around the completeness of balances. 	Our audit work has not identified any significant issues in relation to the risk identified other than Corporate and Democratic core income and expenditure being overstated by £6.6m (see Adjusted Misstatements below).
Employee remuneration	Employee remuneration accrual understated	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> documented our understanding of processes and key controls over the transaction cycle undertaken walkthrough of the key controls to assess whether those controls are designed effectively we carried out detailed substantive testing of employee remuneration balances included in the financial statements We carried out specific work around the completeness of balances. 	<p>Our audit work has identified the following significant issues in relation to the risk identified:</p> <ul style="list-style-type: none"> incomplete information and significant delays in obtaining the requested information (see Internal Controls below) the salary for the Strategic Director of Public Health was incorrectly stated as £126,271. This was amended to £110,095. There were also amendments made to the classification of mileage and expense reimbursements for all the senior officers (see Misclassification and Disclosure changes below) the total contributions expected to be made to the Pension Scheme in the year to 31 March 2015 was amended from £23.77m to £19.37m (see Misclassification and Disclosure changes below)

Audit findings against other risks

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Welfare expenditure	Welfare benefit expenditure improperly computed	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> documented our understanding of processes and key controls over the transaction cycle undertaken walkthrough of the key controls to assess whether those controls are designed effectively reviewed the Benefits system reconciliation to ensure that information from the benefits system can be agreed to the ledger and financial statements carried out procedures in accordance with the methodology required to certify the housing benefit subsidy claim tested a sample of council tax benefit granted under the new Council Tax reduction scheme. 	Our audit work has not identified any significant issues in relation to the risk identified.
Housing Rent Revenue Account	Revenue transactions not recorded	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> documented our understanding of processes and key controls over the transaction cycle undertaken walkthrough of the key controls to assess whether those controls are designed effectively we carried out detailed substantive testing of Housing Rent balances included in the financial statements we carried out specific work around the completeness of balances. 	Our audit work has not identified any significant issues in relation to the risk identified.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property, plant & equipment	PPE activity not valid	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess whether those controls are designed effectively • carried out testing on a sample of PPE transactions throughout the year • reviewed and tested the data migration to the new asset system 	<p>Our audit work has identified the following significant issues in relation to the risk identified:</p> <ul style="list-style-type: none"> • the Council 's rolling programme of asset valuations does not comply with the 2013/14 Code of Practice. There were £75m of assets that had not been revalued in the last five years. As a result there was an audit adjustment of £4.7m (see Adjusted Misstatements below). In addition, items within a class of property, plant and equipment should be valued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. • the Council did not ensure that the carrying value of specialist assets (e.g. schools) is not materially different to fair value. As a result there was an audit adjustment of £26.2m (see Adjusted Misstatements below). • the Council had not reclassified all assets under construction that had been completed. These should have been transferred to the relevant asset category. As a result there was an audit adjustment of £4.1m (see Adjusted Misstatements below). • The Council had incorrectly impaired the Affordable Housing PFI asset to zero. As a result there was an audit adjustment of £4.7m (see Adjusted Misstatements below). • The accounting adjustment for Council dwellings in year price movements was not correctly reflected in the asset register amounting to £1.7m (see Adjusted Misstatements below).

Audit findings against other risks

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Debt (PFI)	PFI obligations not reflected properly	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> documented our understanding of processes and key controls over the transaction cycle undertaken walkthrough of the key controls to assess whether those controls are designed effectively considered whether the scheme falls within IFRIC12 and should be accounted for on balance sheet considered whether the accounting model reflects the operator's model and produces reliable results for the financial statements ensured the outputs from the accounting model are correctly reflected in the financial statements, relevant disclosures have been made and these agree to supporting documentation 	<p>Our audit work has identified the following significant issues in relation to the risk identified:</p> <ul style="list-style-type: none"> The Affordable Housing PFI initial asset recognition and liability was amended to reflect the percentage completion of the scheme. As a result there was an audit adjustment of £1m (see Adjusted Misstatements below). A number of additional disclosures were required (see Misclassification and Disclosure changes below).


Group audit scope and risk assessment

ISA 600 requires that as Group auditors we obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Component	Significant?	Level of response required under ISA 600	Risks identified	Work completed	Assurance gained & issues raised
Derby Homes Ltd	No	Analytical	N/A	Desktop review performed by GT UK	<p>Our audit work has identified the following significant issues:</p> <ul style="list-style-type: none">the Group Debtors and Creditors were amended for a consolidation adjustment error of £6.3m (see Misclassification and Disclosure changes below).the Group Movement in Reserves Statement for 2012/13 was amended for errors of £3.2m in Total Group Usable Reserves and Total Group Unusable Reserves (see Misclassification and Disclosure changes below).

Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	<p>Revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser, it is probable that economic benefits or service potential associated with the transaction will flow to the Council; and the amount of revenue can be measured reliably.</p> <p>Revenue from the provision of services is recognised when the Council can measure reliably the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the Council.</p> <p>Whether paid on account, by instalments or in arrears, government grants and third party contributions and donations are recognised as due to the Council when there is reasonable assurance that:</p> <ul style="list-style-type: none"> • the Council will comply with the conditions attached to the payments; and • the grants or contributions will be received. <p>Amounts recognised as due to the Council are not credited to the Comprehensive Income and Expenditure Statement until conditions attached to the grant or contribution have been satisfied.</p>	<p>The accounting policy is appropriate and has been adequately disclosed. However, an additional accounting policy note was required for revenue recognition in respect of Council Tax and Business Rates.</p>	 amber


Assessment

● Marginal accounting policy which could potentially attract attention from regulators

● Accounting policy appropriate and disclosures sufficient

● Accounting policy appropriate but scope for improved disclosure

Accounting policies, estimates & judgements

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates	<ul style="list-style-type: none"> • Key estimates and judgements include: <ul style="list-style-type: none"> – useful life of capital equipment – pension fund liability – Provisions and contingent liabilities – Impairments – PPE valuations – PFI schemes – Accounting for schools 	An additional disclosure note was required in respect of the critical judgement around the equal pay provision. An additional disclosure was also required relating to contingent liabilities for business rates appeals. In addition, there were a number of additional disclosures relating to the pension fund and PFI schemes (see misclassification and disclosure changes below).	 amber

Assessment

 Marginal accounting policy which could potentially attract attention from regulators

 Accounting policy appropriate and disclosures sufficient

 Accounting policy appropriate but scope for improved disclosure

Adjusted misstatements

A number of adjustments to the draft financial statements have been identified during the audit process. We are required to report all misstatements to those charged with governance, whether or not the financial statements have been adjusted by management. The table below summarises the adjustments arising from the audit which have been processed by management.

Impact of adjusted misstatements

All adjusted misstatements are set out below along with the impact on the primary statements and the reported financial position.

Detail		Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Impact on total net expenditure £000
1	The Council needs to ensure that the carrying value of assets is not materially different to fair value. Where there is no market based evidence of fair value because of the specialist nature of an asset (e.g. schools) depreciated replacement cost is used as an estimate of fair value. For these specialist assets a 9.1% increase in indexation has been applied by the Council. This increase had only been applied to those specialist assets in the 20% of assets revalued and had not been considered in for the remaining 80%.	(26,170)	26,170	(26,170)
2	Assets with a carrying value of £75m had not been revalued within the last five years.	(4,695)	4,695	(4,695)
3	Assets under construction that had been completed and should have been transferred to the relevant asset category.		4,100 (4,100)	
4	Equal Pay provision now included in the accounts.	8,325	(8,325)	8,325

Adjusted misstatements

Detail		Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Impact on total net expenditure £000
5	Corporate and democratic core income and expenditure overstated	6,687 (6,687)		
6	Affordable Housing PFI initial asset recognition and liability amended to reflect the percentage completion of the scheme.		1,021 (1,021)	
7	Affordable Housing PFI asset impairment amended from £15,839k to £11,084k	(4,755)	4,755	(4,755)
8	Accounting adjustment for Council dwellings in year price movements not correctly reflected in asset register	(1,778)	1,778	(1,778)
Overall impact		£(29,073)	£29,073	£(29,073)

Misclassifications & disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Adjustment type	Value £'000	Account balance	Impact on the financial statements
1 Misclassification	2,854	Short term creditors and borrowings	An amendment was made between short term creditors and borrowings for accrued interest.
2 Disclosure	N/A	Note 40 Officers Remuneration	The salary for the Strategic Director of Public Health was incorrectly stated as £126,271. This was amended to £110,095. There were also amendments made to the classification of mileage and expense reimbursements for all the senior officers.
3 Misclassification	3,240	Group Movement in Reserves Statement for 2012/13	The Statement was amended for errors in Total Group Usable Reserves and Total Group Unusable Reserves.
4 Misclassification	6,290	Group Debtors and Creditors	The Group Balance Sheet was amended for a consolidation adjustment error
5 Disclosure	N/A	Various 2012/13 comparative amounts	The accounts were amended for eight errors in the 2012/13 comparative amounts.
6 Disclosure	N/A	Note 25 Private Finance Initiatives and Similar Contracts	The PFI disclosures were enhanced to disclose the impact of inflation on PFI commitments. Additional disclosure was also made regarding renewal/termination options for the Affordable Housing PFI. The disclosure note was also expanded to explain that the Affordable Housing project is phased over a number of years and to provide details of future capital spend/interest over the full life of the project.

Misclassifications & disclosure changes

	Adjustment type	Value £'000	Account balance	Impact on the financial statements
7	Disclosure	N/A	Various disclosure notes	<p>Additional disclosure was made relating to the following:</p> <ul style="list-style-type: none"> the critical judgement in respect of Equal Pay Claims provision. Note 20 inability to provide specified information for heritage assets. providing a brief explanation of the nature of schemes under the Transport Act 2000. Note 44 Additional disclosure was made of the contingent liability for Business Rates appeals which have not yet been received.
8	Disclosure	N/A	Note 43 Defined Benefit Pension Schemes	<p>The total contributions expected to be made to the Pension Scheme in the year to 31 March 2015 was amended from £23.77m to £19.37m.</p> <p>Additional disclosure was made of the maturity profile of defined benefit obligations. In addition, a number of the comparative figures in the disclosure note were amended to the restated figures provided by Mercers. The date of the actuarial valuation dated was also amended from 31 March 2013 to 31 March 2014.</p>
9	Disclosure	N/A	Accounting Policies	Additional accounting policy note was made for revenue recognition in respect of Council Tax and Business Rates.

Misclassifications & disclosure changes

	Adjustment type	Value £'000	Account balance	Impact on the financial statements
10	Disclosure	N/A	Explanatory Foreword	The Net Pensions Liability disclosed in the Explanatory Foreword was not consistent with note 32. The Explanatory Foreword showed an increase in the net liability of £66.425m. In fact it should have been a decrease of £53.068m. The Explanatory Foreword showed a net pension liability of £336.496m. It should have been £283.428m. In addition, the date of the Code of Practice was amended from 2012 to 2013/14.
11	Disclosure	N/A	Comprehensive Income & Expenditure Statement and note 43	An amendment was required as the old IAS 19 terminology had been used. Actuarial gains/losses was replaced with remeasurement of the net defined benefit liability. In addition, interest cost and expected return on scheme assets was replaced with net interest on the net defined benefit liability.
12	Disclosure	N/A	Note 37 Related Party Transactions	Additional disclosure was made of the two loans with Derby Homes Limited for £1.1m and £200k and the borrowings from Staffordshire County Council of £15m. In addition, the disclosure note for Members and Chief Offices stated that during 2013/14 services to the value of £708,000 were commissioned from companies in which one Member and one Director had interests. This was amended to three Members and no Directors.

Misclassifications & disclosure changes

	Adjustment type	Value £'000	Account balance	Impact on the financial statements
13	Misclassification	25,872	Note 12 Taxation and Non-Specific Grant Income	Revenue Support Grant was amended from £49,922k to £75,794k. Business Rates Top Up Grant was amended from £38,539k to £12,666k.
14	Disclosure	N/A	Note 13 Accounting for Local Government Schools	The analysis of maintained schools contained several misstatements. For non PFI schools these changed from Community 64, Voluntary Controlled 1, Voluntary Aided 7, Foundation 5, Special 6 and total 83 to Community 61, Voluntary Controlled 1, Voluntary Aided 9, Foundation 5, Special 6 and total 82. For PFI schools these changed from Community 4, Foundation 1, Special 0 and total 5 to Community 3, Foundation 2, Special 1 and total 6. As a result the disclosure of the value of land and buildings for each school category was misstated. In addition, the disclosure note states that the Council has one school which is subject to its BSF PFI contract. In fact there are two schools subject to this contract.
15	Disclosure	N/A	Note 23 Capital Expenditure and Capital Financing	Within the capital investment section the following items had been omitted: purchase of intangible assets £374k, de minimis capital expenditure £831k and long term loan £3.5m. Within the sums set aside from revenue section, direct revenue contributions changed from £3,445k to £4,795k.
16	Disclosure	N/A	Notes to Housing Revenue Account	There were a number of amendments to the HRA disclosure notes

Misclassifications & disclosure changes

	Adjustment type	Value £'000	Account balance	Impact on the financial statements
17	Disclosure	N/A	Notes 26 & 27 Financial Instruments	There were numerous amendments to the Financial Instruments disclosure. Debtors were amended from £14,760k to £18,799k. Short term creditors was amended from £44,729k to £50,446k. The interest expense for 2012/13 was changed from £5,828k to £18,907k. The interest expense for 2013/14 was amended from £6,060k to £20,203k. The fair value of the Council's £15m long term loan with Staffordshire County Council was amended from nil to £15.6m. The carrying value of the PFI liabilities was not consistent with the Balance Sheet value.



Unadjusted misstatements

There are no unadjusted misstatements. All adjustments identified during the audit have been made within the final set of financial statements.



Internal controls

The purpose of an audit is to express an opinion on the financial statements.


Our audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards. These and other recommendations, together with management responses, are included in the action plan attached at Appendix A. We have not repeated the weaknesses identified from our systems work and reported in our Audit Plan.

	Assessment	Issue and risk	Recommendations
1.	 amber	Internal Audit has reported a number of weaknesses in its review of payroll and gave only limited assurance. In common with Internal Audit we had long delays in receiving information from the payroll department and in a number of instances the information provided was incomplete. This resulted in significant delays to the audit of payroll expenditure.	<ul style="list-style-type: none"> The Council should ensure that the payroll weaknesses identified by Internal Audit are addressed as a priority. In addition, a review of the arrangements for filing and retrieval of HR files should be carried out .
2.	 amber	We identified a control weakness from our testing of welfare expenditure. The Academy System allows claims to be set up with the same national insurance number as a claim already in progress. The weakness could lead to fraudulent activity.	<ul style="list-style-type: none"> The Academy System should automatically generate a warning message if a national insurance number is duplicated or entered in an incorrect format.

Assessment

-  Significant deficiency – risk of significant misstatement
-  Deficiency – risk of inconsequential misstatement

Internal controls

	Assessment	Issue and risk	Recommendations
3	 amber	<p>Our review of the Council's ICT arrangements identified the following weaknesses:</p> <ul style="list-style-type: none"> • Lack of updated information security policies – network • Lack of user access rights review – network and payroll • Lack of robust password controls – network and payroll • No automatic notification of leavers – all applications • Back-up testing/restoration is not routinely performed – payroll • Lack of robust change management processes – network • Lack of proactive review of audit logs – all applications 	<ul style="list-style-type: none"> • The Council should ensure that the ICT weaknesses identified are addressed as a priority.

Assessment

- Significant deficiency – risk of significant misstatement
- Deficiency – risk of inconsequential misstatement

Other communication requirements

We set out below details of other matters which we are required by auditing standards to communicate to those charged with governance.

	Issue	Commentary
1.	Matters in relation to fraud	<ul style="list-style-type: none"> We have previously discussed the risk of fraud with the Audit and Accounts Committee. We have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit.
2.	Matters in relation to laws and regulations	<ul style="list-style-type: none"> There are currently investigations underway that may impact on compliance with relevant laws and regulations. The Council have recognised weaknesses in this area and as a result have revisited reporting lines.
3.	Written representations	<ul style="list-style-type: none"> A letter of representation has been requested from the Council. In particular, representations will be requested from management in respect of the significant assumptions used in making accounting estimates for the equal pay provision and PFI liabilities.
4.	Disclosures	<ul style="list-style-type: none"> Our review found a number of omissions in the financial statements (see misclassifications and disclosure changes above).
5.	Matters in relation to related parties	<ul style="list-style-type: none"> As noted above we identified related party transactions which had not been disclosed. We also noted that 17% of annual declarations had not been returned by Members. There is the potential for non disclosure of related party transactions regarding these Members.
6.	Going concern	<ul style="list-style-type: none"> Our work has not identified any reason to challenge the Council's decision to prepare the financial statements on a going concern basis.
7.	Annual Governance Statement (AGS)	<ul style="list-style-type: none"> We have reviewed the AGS and it reflects our understanding of the Council's governance arrangements. The AGS has however identified a range of weaknesses in relation to governance and project governance in particular. As a result of concerns about its strategic partner for the job evaluation project, the Council has appointed new consultants, Hay Group, at a cost of £1.1m to complete the job evaluation process. The AGS also notes that the Council's s151 officer was suspended from his duties in July 2014 along with another senior manager, in relation to a range of matters currently being investigated in relation to project governance. The Council states in its AGS that the investigation has not concluded and therefore we are not able to determine or quantify at this stage the impact on the overall governance framework of the Council. In addition the Council has also noted, 'as highlighted by the job evaluation project ... recent evidence suggests that decisions have been made without the Director of Legal and Democratic Services input.' The AGS also notes that the Information Commissioner's Office is currently considering what action to take, if any, in connection with information found by Internal Audit on job evaluation that would have been covered by FOI requests. Going forward, we will continue to liaise with the Council on progress in these areas and we note that the Council has already put in place a number of changes to arrangements, including stipulating that the Monitoring Officer will report direct to the Chief Executive Officer, which will serve to address a number of the governance weaknesses identified in the AGS.

Other communication requirements

	Issue	Commentary
8.	Other matters	<ul style="list-style-type: none">The auditors of the Derbyshire Pension Fund have reported system weaknesses relating to pension payments. Under and over payments have been identified as a result of a reconciliation exercise between AXISe (the pensions database) and SAP (the Fund's finance and payroll system). There is no automated interface between the two systems. The Fund's reconciliation identified around 2,450 cases where the pension amounts were different in the two systems and around 1,200 cases remain to be investigated. Of the cases reviewed so far, there have been 44 cases where the amounts paid were wrong, resulting in either under or over payments to the pensioner – 16 were under and 28 over payments. The largest single overpayment error to date is approximately £15k to one of the pensioners. There are only two errors greater than £3k. The total amount written off to date for overpayments is approximately £130k. All under payments identified to date have been corrected and arrears paid.

Section 3: Value for Money

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Value for Money

Value for money conclusion

The Code of Audit Practice 2010 (the Code) describes the Council's responsibilities to put in place proper arrangements to:

- secure economy, efficiency and effectiveness in its use of resources;
- ensure proper stewardship and governance; and
- review regularly the adequacy and effectiveness of these arrangements.

We are required to give our VFM conclusion based on two criteria specified by the Audit Commission which support our reporting responsibilities under the Code. These criteria are:

The Council has proper arrangements in place for securing financial resilience - the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

The Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness - the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Key findings

Securing financial resilience

We have considered the Council's arrangements to secure financial resilience against the following themes:

- Key financial performance indicators
- Financial governance
- Financial planning
- Financial control

Overall our work highlighted that Members and Officers continue to work well together to ensure that the Medium Term Financial Strategy (MTFS) is realistic and reflects the Council's objectives. Annual budgets are thoroughly scrutinised before approval. Robust and timely budget monitoring and reporting highlight any issues in a timely manner. The Council has reasonable levels of reserves and plans to deliver balanced budgets over the lifetime of its MTFS. However, the Council deployed £10.7m to support the 2013/14 budget, which was planned. The Council plans to use £1.85m of reserves to support the 2014/15 budget and it will need to ensure that it continues to hold an adequate level of resources going forward as cost pressures increase. The Council is facing particular cost pressures in relation to Adult Care spending in 2014/15.

Challenging economy, efficiency and effectiveness

We have considered the Council's arrangements to challenge economy, efficiency and effectiveness against the following themes:

- Prioritising resources
- Improving efficiency & productivity

Overall our work highlighted that the Council's approach to delivering corporate and directorate cost savings continues to be robust and is increasingly directed to transformational savings focused on service re-design, such as a corporate review of demand management. The effectiveness of the Council's arrangements was recognised by the LGC in 2014; Derby winning the Efficiency Award for delivering £67.4m of savings and targeting savings of £63.3m by March 2017. The future looking savings programme is ambitious but the Council has good processes in place to deliver efficiencies. The financial landscape however looks increasingly challenging.

Value for Money

Our Audit Plan explained that for both Local Authorities with Adult Social Services and CCGs we identified the Better Care Fund (BCF) as an area of focus. We therefore carried out cross-cutting work in conjunction with colleagues to ensure that, as a health economy, Derby has appropriate arrangements in place to address the challenges and requirements of the BCF

Our work focused on the arrangements in place to work with other organisations to develop and submit the BCF Plan. We are able to conclude that the Council to date has achieved the timescale and assurance requirements set by NHS England.

Our work identified that the BCF has good joint working with local CCGs and the reports were prepared as required and submitted to the Health and Well Being Board in accordance with the national timetable.

The Council will need to continue working with BCF partners to ensure the opportunities afforded are seized and the health benefits for the people of Derby are realized.

We referred in the Audit Findings section to the failures of governance highlighted in the Council's AGS. In addition, the AGS notes that the Information Commissioner's Office is currently considering what action to take, if any, in connection with information found by Internal Audit on job evaluation that would have been covered by FOI requests. Work is underway by the Council to investigate these issues.

Overall VFM conclusion

On the basis of our work, and having regard to the guidance on the specified criteria published by the Audit Commission, we are satisfied that in all significant respects the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2014.

We set out below our detailed findings against six risk areas which have been used to assess the Council's performance against the Audit Commission's criteria. We summarise our assessment of each risk area using a red, amber or green (RAG) rating, based on the following definitions:

Green	Adequate arrangements
Amber	Adequate arrangements, with areas for development
Red	Inadequate arrangements

The table below and overleaf summarises our overall rating for each of the themes reviewed:

Theme	Summary findings	RAG rating
Key indicators of performance	The Council's financial ratios are broadly similar to those of other Councils (based on 2011-12 Audit Commission data). The working capital ratio has declined from 1.29 (11/12) to 0.81 (13/14) but this may be due in large part to timing differences around year-end movements, and is not an area of concern. Financial forecasting and budget monitoring are robust. Uncommitted financial balances at £7m are at a reasonable level but the Council will need to ensure that balances remain sufficient.	Green
Strategic financial planning	The Council's MTFS agreed in August 2013 is underpinned by realistic assumptions and is designed to deliver the Council's priorities. The MTFS provides for a balanced budget in each of its three years but will require savings to be delivered of £28m in 2014/15; £30m in 2015/16 and £20.9m in 2016/17. £1.8m of reserves were planned to be used to support the 2014/15 budget. The long term financial picture remains very challenging but the Council has sound arrangements to develop the budget, involving extensive internal and external challenge of the emerging budget and extensive scrutiny by senior officers and members. The Council has a track record of delivering its cost improvement targets and is increasingly focusing on transformational changes which will deliver more substantial savings opportunities.	Green
Financial governance	The leadership team, including senior members, are aware of the challenging position the Council faces and the need to make savings. Members are well briefed by the Finance team. Both revenue and capital budgets are reported to Cabinet quarterly. The reporting is at the right level of detail.	Green
Financial control	The Council prepares realistic budgets and has a prudent approach to planning and forecasting. Savings plans are developed well in advance and are delivered. However the overall rating has been reduced from Green (12/13) to Amber (13/14) due to a number of factors. Weaknesses in the accounts preparation, detailed in the Audit findings section have led to a number of significant changes to the accounts. Internal Audit has also identified weaknesses in financial control, for instance in relation to payroll, and we have identified scope to improve controls in relation to ICT arrangements. The Council will need to address these issues going forward to strengthen financial control.	Amber

Theme	Summary findings	RAG rating
Prioritising resources	<p>The Council's MTFS is keyed into the Council's overall corporate plan and reflects its priorities. The Council consults extensively with internal and external stakeholders to ensure that its budget strategy takes account, where possible, of the views of the wider community and of business and other partners. The Council's corporate strategy has four key priorities:</p> <ul style="list-style-type: none"> • Better outcomes for our communities • Improved value for money for our customers • More efficient and effective processes • A skilled and motivated workforce <p>The Adult Care and Children's budgets are however increasingly coming under severe pressure and the Council may need to respond by re-examining priorities to ensure that competing cost pressures can continue to be accommodated.</p>	Green
Improving efficiency & productivity	<p>The Council's processes for reviewing efficiency and developing long-term cost improvement programmes, are effective. During the preparation of the Budget which commences in the summer, the Directorates are required to develop service plans which incorporate challenging savings targets which are scrutinised by officers and members and also by a Star Chamber involving the Leader, Chief Executive and Director of Resources. Specific savings targets are included within the Budget at the beginning of the year for each Directorate. The Council has a good track record in delivering savings.</p>	Green

Section 4: Certifying the audit closed

01. Executive summary

02. Audit findings

03. Value for Money

04. Certifying the audit closed

05. Fees, non audit services and independence

06. Communication of audit matters

Certifying the audit closed

The audit certificate

The Code of Audit Practice 2010 (the Code) requires auditors to formally certify at the end of the audit that they have undertaken the audit in accordance with the requirements of the Code.

This includes all of the work required to issue an opinion on the Council's financial statements and the value for money conclusion.

It also includes consideration of any matters that might require formal audit action.

We are unable to issue the certificate to confirm this and to certify the 2013/14 audit closed.

This is because we are awaiting the outcome of the Council's work to investigate issues relating to failures of governance highlighted in the Council's AGS.

Section 5: Fees, non audit services and independence

01. Executive summary

02. Audit findings

03. Value for money

04. Certifying the audit closed

05. Fees, non audit services and independence

06. Communication of audit matters

Fees, non audit services and independence

We confirm below our final fees charged for the audit and provision of non-audit services.

Fees

	Per Audit plan £	Actual fees £
Council audit	189,000	190,070
Grant certification	37,700	30,764
Total audit fees	226,700	220,834

There is an additional fee of £1,070 in respect of work on material business rates balances. This additional work was necessary as auditors are no longer required to carry out work to certify NDR3 claims. The additional fee is 50% of the average fee previously charged for NDR3 certifications for unitary authorities and is subject to agreement by the Audit Commission

Fees for other services

Service	Fees £
Assurance statement to the Regional Growth Fund	6,050

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

Section 6: Communication of audit matters

01. Executive summary

02. Audit findings

03. Value for money

04. Certifying the audit closed

05. Fees, non audit services and independence

06. Communication of audit matters

Communication of audit matters to those charged with governance

International Standard on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks when reaching our conclusions under the Code.

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Compliance with laws and regulations		✓
Expected auditor's report		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

Appendices

Appendix A: Action plan

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
1	The Council should review its quality assurance arrangements and level of resources for producing the financial statements and responding to audit queries.	High	As for all previous years we will conduct a post audit review of our arrangements for preparing the Councils accounts. Quality assurance and response times will be key consideration and will be shared across relevant parties within Directorates. The level of resources assigned to the closure of the accounts will be subject to overall resource levels across the service and the Council.	Corporate HoF - March 2015
2	The Council should ensure that the payroll weaknesses identified by Internal Audit are addressed as a priority. In addition, a review of the arrangements for filing and retrieval of HR files should be carried out.	High	The Council takes weaknesses identified very seriously. The Chief Executive has initiated a review of the HR service of which this will form part.	Interim Director of HR - March 2015
3	The Academy System should automatically generate a warning message if a national insurance number is duplicated or entered in an incorrect format.	Medium	The identified weakness will be corrected in a new software release due by the year end.	J Massey - March 2015
4	The Council should ensure that the ICT weaknesses identified are addressed as a priority.	High	We have responded directly on the ICT weakness issues raised. Seven issues were raised, all of which are accompanied by appropriate management responses, with lead officers and deadlines.	Various
5	The Council should ensure that all annual declarations are returned by Members.	Medium	We will continue to remind members of the responsibility to return annual declarations, including via representatives from the Audit and Accounts Committee.	Janie Berry - March 2015

Appendix B: Audit opinion

We anticipate we will provide the Council with an unmodified audit report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DERBY CITY COUNCIL

Opinion on the financial statements

We have audited the financial statements of Derby City Council for the year ended 31 March 2014 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Group Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Group Comprehensive Income and Expenditure Statement, the Balance Sheet, the Group Balance Sheet, the Cash Flow Statement, the Group Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and Collection Fund and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

This report is made solely to the members of Derby City Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's Members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Strategic Director of Resources and auditor

As explained more fully in the Statement of the Strategic Director of Resources Responsibilities, the Strategic Director of Resources is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority and Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Strategic Director of Resources; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of Derby City Council as at 31 March 2014 and of its expenditure and income for the year then ended;
- give a true and fair view of the financial position of the Group as at 31 March 2014 and of its expenditure and income for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and applicable law.

Opinion on other matters

In our opinion, the information given in the explanatory foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
- we issue a report in the public interest under section 8 of the Audit Commission Act 1998;
- we designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
- we exercise any other special powers of the auditor under the Audit Commission Act 1998.

We have nothing to report in these respects.

Conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources

Respective responsibilities of the Authority and the auditor

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

We are required under Section 5 of the Audit Commission Act 1998 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2013, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2013, we are satisfied that, in all significant respects, Derby City Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of the Council's ongoing work to investigate issues relating to failures of governance highlighted in the Council's Annual Governance Statement. We are satisfied that these matters do not have a material effect on the financial statements or a significant impact on our value for money conclusion.

Phil Jones
Director
for and on behalf of Grant Thornton UK LLP, Appointed Auditor

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Date



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