

Secretary of State  
Department for Communities and Local Government  
2 Marsham Street  
London  
SW1P 4DF

27 June 2017

Ref:

Email: sclark3@uk.ey.com

Mr Paul Robinson  
Derby City Council  
The Council House  
Corporation Street  
Derby  
DE1 2FS

Dear Secretary of State / Paul

## **Recommendations made under Section 24 Schedule 7 (2) of the Local Audit and Accountability Act 2014**

I am writing on behalf of Ernst & Young LLP in its capacity as appointed auditor to Derby City Council.

Section 24 of the Local Audit and Accountability Act 2014 refers to Schedule 7(2):

### Written recommendations

2(1) A local auditor of the accounts of a relevant authority may make a written recommendation to the authority relating to the authority or an entity connected with it, so that the recommendation can be considered under this Schedule.

(2) A recommendation may be made during or at the end of an audit.

(3) A recommendation must be sent at the time it is made—

(a) to the Secretary of State, .....

### Recommendation 1

Appendix 1 to this letter contains a number of control observations. These observations were first brought to the attention of management (in writing) in our 23 September 2016 progress report to the Audit and Accounts Committee.

Although some progress has been made, it is our view that given the significance of these control weaknesses, insufficient progress has been made in the period following our report of 23 September 2016 to appropriately address the issues and strengthen the Council's control environment. The control issues identified across a significant number of areas of the Finance and associated supporting functions, most noticeably in respect of the Estates function, are pervasive and led to a significant number of errors identified in the published draft Financial Statements relating to both the current and

prior year accounting periods. This could undermine the Council's ability to effectively demonstrate it has proper arrangements to safeguard and make informed decisions in respect of public funds and assets.

This letter therefore sets out our written recommendation, under Section 24 Schedule 7 (2) of the Local Audit and Accountability Act 2014, that the Council implements an action plan (no later than 19 July 2017) against each of the control observations noted in Appendix 1 to this letter, assign a deadline for completion and an Officer with responsibility and accountability for the action being implemented.

In implementing the action plan, the Council should review its Finance and supporting functions in order to ensure that they are fit for purpose to address both the specific issues raised and the ongoing need to effectively demonstrate it has proper arrangements to safeguard and make informed decisions in respect of public funds and assets.

## Recommendation 2

As a result of inadequate arrangements for closedown of the financial statements caused by a number of the control observations identified in Appendix 1, the Council was unable to achieve the 30 June 2016 deadline for publication of the draft financial statements, as set out in the CIPFA Code of Practice on Local Authority Accounting ('the Code'). The draft financial statements were produced on 25 July 2016. The Council is required by the Code to published audited financial statements by 30 September. The Council was also unable to meet this deadline. The Council itself set a deadline of 31 March 2017 for completion of audited financial statements. This deadline has also not been achieved, primarily due to ongoing issues with regards to the valuation of Property, Plant and Equipment. At the time of writing this recommendation, the Council has set a revised target for the completion of the audited financial statements of 30 September 2017.

As a result of significant delays to the completion of the 2015/16 financial statements, the Council has indicated that it will not achieve the deadline for publication of draft financial statements by 30 June 2017 in respect of the 2016/17 financial statements, nor will it achieve publication of these audited financial statements by 30 September 2017. The Council has indicated that the audited 2016/17 financial statements will be completed by 31 December 2017.

This letter therefore sets out our written recommendation, under Section 24 Schedule 7 (2) of the Local Audit and Accountability Act 2014, that the Council prepares an action plan (no later than 19 July 2017) to ensure the delivery of the audited 2015/16 and 2016/17 financial statements by the 30 September 2017 and 31 December 2017, respectively. This action plan should be effectively monitored and progress reported against it to the Council.

## Next steps

We expect this report to be considered at the next Full Council meeting, and a written response prepared, setting out the actions to be taken and the timeframes to be followed.

By 21 July 2017 we will review the Council's response to this recommendation and progress made, and consider this against our duties as your auditor.

## Reporting

In accordance with the requirements of section 24 schedule 7 (2) of Local Audit and Accountability Act 2014 a copy of this letter has been sent to the Secretary of State for Local Government and the Communities. A copy of this report has also been sent to the Public Sector Audit Appointments Ltd (PSAA).

Yours sincerely



Stephen Clark  
Partner  
For and on behalf of Ernst & Young LLP  
United Kingdom

## Appendix 1

Observation and recommendation
<p><b>Property, Plant and Equipment</b></p> <p>There were no reconciliations performed between the SAM system (used by the Estates team) and the RAM system (used by the finance team). This meant that the Council was unable to satisfy itself that the assets recorded in the financial statements were complete, exist, owned by the Council, and valued appropriately. A reconciliation has now been performed at our request.</p> <p>This reconciliation must be maintained going forward.</p>
<p>All valuations are performed manually using Microsoft Excel. The data from the Excel spreadsheet is 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 increases 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. We have seen evidence of poor control over the valuation models in Excel which leads to errors and inconsistency of approach.</p> <p>The Council must put in place robust controls over the data within the Excel valuation models and the transfer of such data to the SAM/RAM systems.</p>
<p>The Council obtains significant amounts of data to support the asset valuations made. However, the source of the data is not always clear, and the analysis of the data and how it has been applied to the resultant valuation is not clearly documented. There is a tendency to list comparables without analysis as to the context and asset in question. With so many assets in similar geographic area, often a single list is applied to multiple assets without application to the specific asset in question. This means that asset valuations are difficult to review and challenge.</p> <p>All asset valuations should be evidenced as reviewed by an appropriately qualified individual.</p>
<p>Robust review and challenge of valuations has been difficult for the Authority to achieve. We note that there have 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.</p> <p>A stable robust staffing structure needs to be created and maintained within the Council's Estates team, supported, as deemed necessary, by the use of outside expertise.</p>
<p>There is no robust process in place to ensure that significant events giving rise to impairment or other significant change in valuation are appropriately considered in the valuation of PPE. This has meant that valuations are not updated on a timely basis to reflect significant events impacting on the valuation of assets.</p> <p>The Council's close-down process for the preparation of the annual statement of accounts needs to include provision for the documented review of indicators of impairment.</p>
<p><b>Asset lives are not reassessed on a timely basis</b></p> <p>Our audit procedures found that assets that had a 1 year life span at beginning of period were not</p>

Observation and recommendation
<p>assessed for a new useful life where capital additions had been made, and so fully depreciated in the year. The value of these additions and depreciation is £4.9m.</p> <p>Failure to reassess asset lives on a timely basis leads to:</p> <ul style="list-style-type: none"> <li>· Depreciation charges at risk of misstatement,</li> <li>· Inaccurate information used for maintenance/capital replacement programs, and insurance needs.</li> </ul> <p>The Council's close-down process for the preparation of the annual statement of accounts needs to include provision for the documented review of asset lives.</p>
<p>A significant proportion of PPE additions relates to 'Eureka fees', effectively the capitalisation of management time to projects. The rates used are not formally approved and the amounts logged in the spreadsheet for eureka fees did not reconcile to the general ledger.</p> <p>Capitalization 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.</p>
<p>No reconciliation between the fixed asset register and the general ledger takes place throughout the year – everything is done at the year end. This puts significant pressure of the limited resource in the finance team to close and reconcile the PPE balances. This increases the risk that the Council is unable to meet the statutory deadline for preparation of its statement of accounts.</p> <p>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.</p>
<p>The use of indexation to approximate asset valuation movements is a blunt instrument and difficult to justify when individual asset valuations are challenged.</p> <p>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 is being applied.</p>
<p>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 above increases the risk that the valuation of PPE recorded in the financial statements will be materially misstated.</p> <p>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.</p>
<p>Descriptions of assets were not clear due to historical capturing of the capital expenditure. This resulted in certain assets being written off in the asset register as a result of not being verified. Assets to the value of £5.5.million relating to parks could be not verified and was written down.</p> <p>The Council should ensure that all capital expenditure is appropriately described in the asset register, and matched to the relevant existing asset (where applicable).</p>
<p>Timelines were not appropriately set, adhered to and monitored to ensure that adequate review time was</p>

<b>Observation and recommendation</b>
<p>set for working papers across departments.</p> <p>The Council needs to ensure that a detailed project plan is in place for preparation of the statutory financial statements and an individual is given responsibility for ensuring that all departments adhere to the quality and timing requirements contained therein.</p>
<b>Cash and bank balances</b>
<p>The Council has insufficient oversight of the cash management function and this should be addressed as a matter of priority.</p> <p>We have noted several concerns with respect to the record keeping and financial controls in place around the management and recording of cash balances.</p> <p>The Council should put in place the following recommendations:</p> <ul style="list-style-type: none"> <li>▶ Cash in hand balances should be reconciled at the year-end date, or for school balances; where school holidays fall over the year-end date, as near to it as practicable.</li> <li>▶ All cash/bank accounts should be reconciled, regardless of value.</li> <li>▶ Reconciling items should be cleared in a timely manner.</li> <li>▶ Evidence should be presented with the cash and bank reconciliations to enable the reviewer to be satisfied that the reconciliation has been performed correctly and to an appropriate quality.</li> <li>▶ All cash/bank reconciliations should be subject to a detailed review. This detailed review should be evidenced on the working paper.</li> <li>▶ A high level review and challenge of balances in the cash/bank accounts should be performed on a monthly basis such that the Council understands the reasons for significant movements.</li> </ul>
<b>Record keeping and reconciliations to the general ledger</b>
<p><b>Reconciliation between Council Tax and NNDR System and the General Ledger</b></p> <p>No reconciliations have been performed between the Council Tax/NNDR system and the general ledger throughout the year.</p> <p>The Council should reconcile these feeder systems to the General Ledger on a monthly basis, clearly setting out the reason/source of reconciling differences by way of working papers to support the reconciliation.</p> <p>The reconciliation should be subject to a detailed review, and evidenced as having received such.</p>
<p><b>Reconciliation between Tenants Rental Income Ledger and the General Ledger</b></p> <p>No reconciliations have been performed between the Tenants Rent system and the general ledger throughout the year.</p> <p>The Council should reconcile these feeder systems to the General Ledger on a monthly basis, clearly</p>

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<p>setting out the reason/source of reconciling differences by way of working papers to support the reconciliation.</p> <p>The reconciliation should be subject to a detailed review, and evidenced as having received such.</p>
<p>We have observed several instances of control failure and poor practice with respect to record keeping which appears to have been caused by a lack of appropriately experienced resource, and effective supervision and review. Examples include:</p> <ol style="list-style-type: none"> <li>1. Failure to determine NNDR write-offs (In 2014/15 NNDR Debt Write Offs were £1.4mn. For 2015/16 write-offs have been £200k). We have been told that this is due to a shortage of staff able to perform this exercise.</li> <li>2. Lack of understanding/challenge of provisions made against Tenants Rents receivable</li> <li>3. Accounts receivable and Accounts payable reconciliations have not been performed on a monthly basis throughout the audit period.</li> </ol> <p>The Council should put in place the following recommendations:</p> <ul style="list-style-type: none"> <li>▶ The Council should put into place procedures to ensure that write-offs are identified, approved and actioned on a timely basis.</li> <li>▶ Where provision is made with respect to receivables balances, this should be done based on a documented and reviewed approach, taking into account all relevant data and assumptions.</li> <li>▶ Further, the Council should be reconciling all sub-ledgers to the general ledger on a monthly basis and ensuring that reconciling items are appropriately dealt with, and in a timely manner.</li> </ul>
<b>Role transition, accountability and review/support</b>
<p><b>Role transition without appropriate handover</b></p> <p>We have noted several instances where resource changes in the year have occurred, but the required amount of handover has not been performed. This has led to individuals being unclear as to the requirements of the role, and despite their best efforts, being unable to respond to audit enquiries.</p> <p>The Council needs to ensure that there is a sufficiently robust process for role transition in place, together with sufficient cross-working arrangements to enable appropriate levels of support and coaching to individuals new to roles.</p>
<p><b>Lack of accountability of individual service teams</b></p> <p>Our audit procedures revealed examples of service teams providing information to the corporate accounting team for inclusion in the year-end financial statements which is delivered either late, without proper review, or both. For example, the schedule of accumulated absences provided to the Corporate accounting team by HR was so inaccurate that they were unable to use the data and instead resorted to re-using the prior year data as an approximation to current year.</p> <p>The Council needs to put in place a process to ensure that data inputs to the statutory accounts close-down process are provided in accordance with specifications discussed and agreed in advance with service contributors, and with sufficient time for review and challenge by the finance team.</p>

