City of Edinburgh Council

2022/23 Annual Accounts Audit

Prepared for the Members of the City of Edinburgh Council and the Controller of Audit

October 2023

Contents

Key messages

2022/23 annual accounts

1. Audit opinions on the annual accounts of the council, its group and the section 106 charities administered by the council are unmodified.
2. The management commentary, annual governance statement and remuneration report were consistent with the financial statements and properly prepared in accordance with the applicable guidance.

Introduction

1. This report summarises the significant findings from the 2022/23 audit of City of Edinburgh Council's annual accounts. The scope of the audit was set out in an annual audit plan presented to the 2 May 2023 meeting of the Governance, Risk and Best Value Committee. Our Annual Audit Report covering all aspects of the 2022/23 audit will be published in the autumn.

Audit appointment from 2022/23

2. The 2022/23 financial year was the first of our five-year appointment. The appointment coincides with the new Code of Audit Practice which was introduced for financial years commencing on or after 1 April 2022.

3. We would like to thank the Service Director – Finance and Procurement and his team for their cooperation and assistance in carrying out our audit. Their support to the audit was excellent.

Responsibilities and reporting

4. The council has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices. The council is also responsible for compliance with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

5. The responsibilities of the independent auditor are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice 2021, and supplementary guidance and International Standards on Auditing in the UK.

6. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management of the council from its responsibility to address the issues we raise and to maintain adequate systems of control.

Auditor Independence

7. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2022/23 audit fee of £682,060 as set out in our 2022/23 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

1. Audit of 2022/23 annual accounts

Public bodies are required to prepare annual accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Main judgements

Our audit opinions on the annual accounts of the council, its group and the section 106 charities administered by the council are unmodified.

The management commentary, annual governance statement and remuneration report were consistent with the financial statements and properly prepared in accordance with the applicable guidance.

Audit opinions on the annual accounts are unmodified

8. The annual accounts for the City of Edinburgh Council and its group for the year ended 31 March 2023 are due to be scrutinised by the Governance, Risk and Best Value Committee on 19 September 2023 and approved by the Finance and Resources Committee on 21 September 2023. As reported in the proposed independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the audited part of the remuneration report was prepared in accordance with the financial reporting framework
- the management commentary and annual governance statement were consistent with the financial statements and properly prepared in accordance with the applicable requirements.

Our audit opinions on the council's charities are unmodified but attention is drawn to the future of Lauriston Castle Trust

9. Due to the interaction of section 106 of the Local Government (Scotland) Act 1973 with charities legislation, a separate independent auditor's report is required for the council's registered charities where the City of Edinburgh Council is the sole trustee, irrespective of the size of the charity. The financial statements have been prepared using the connected charities provisions under The Charities Accounts (Scotland) Regulations 2006. These charities are:

- Jean Fletcher Watson (SC018971)
- Edinburgh Education Trust (SC042754)
- Nelson Halls Trust (SC018946)
- Lauriston Castle Trust (SC020737)
- The Royal Scots (The Royal Regiment) Monument Trust Fund (SC018945)

10. On 20 June 2023, the Finance and Resources Committee considered a report on the Lauriston Castle Trust and options for reshaping governance arrangements. The committee approved to apply to the Court of Session to use the *nobile officium* to approve the winding up of the Lauriston Castle Trust and the transfer of assets to the council. Our understanding is that the legal mechanism for doing so has not yet been initiated.

11. A going concern basis may be appropriate if a body is being wound up in an orderly and planned manner, and that basis provides a faithful representation of the items in the financial statements. As the trust continues to have financial backing to utilise its assets and meet liabilities as they fall due, and particularly as the intention is to transfer ownership to the council, we have concluded that the going concern basis is appropriate. Our independent auditor’s report includes an emphasis of matter paragraph to draw attention to this specific issue.

12. The trustee prepared the financial statements for the City of Edinburgh Council Charitable Funds (Boyd Anderson) as a separate set of accounts, adopting a break-up basis of accounting, as it considered that the fund was not a going concern. Our opinion was not modified in respect of this matter. Our independent auditor’s report on this set of annual accounts also includes an emphasis of matter paragraph to draw attention to this issue.

Overall materiality was assessed as £53 million

13. Broadly, the concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and hence impact their opinion set out in the independent auditor’s report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature. It is ultimately a matter of the auditor’s professional judgement.

14. Our initial assessment of materiality was carried out during the risk assessment and planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual accounts and is summarised in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£53 million
Performance materiality	£35 million
Reporting threshold	£250,000
Source: Audit Scotland	

15. The overall materiality threshold for the audit of the annual accounts of the council was set with reference to gross expenditure, which we judged as the figure most relevant to the users of the financial statements.

16. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 65% of overall materiality, reflecting that the council does not have a history of significant errors, errors have largely been confined to fixed assets in previous years, and all audit findings were adjusted in the finalised set of financial statements.

17. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

Our audit work responded to the risks of material misstatement we identified in the annual accounts

18. We have obtained audit assurances over the identified significant risks of material misstatement in the annual accounts. The Independent Auditor's Report sets out the key audit matters that were of most significance to the audit. These largely include the significant risks of material misstatement to the financial statements and other areas of audit focus we had identified in our Annual Audit Plan. In addition, it covers material elements of the council's group accounts. The Independent Auditor's Report also summarises the further audit procedures we performed to obtain assurances over these matters and the conclusions from the work completed. The key audit matters were:

- Risk of material misstatement due to fraud caused by management override of controls.
- Significant estimation and judgements are required in the measurement, valuation and disclosures of material account balances. This includes non-current assets, pensions disclosures and service concession arrangements.

- Expenditure may be misstated due to risk of fraud over expenditure recognition.

Misstatements of £703 million were adjusted in the audited accounts

19. There were a number of material adjustments made to the audited version of the financial statements as compared to the version presented for audit in June. The gross value of these adjustments was £703 million. The most significant is the restriction of the pension asset value recognised in the accounts which reduced the amount from £597.5 million to nil (See Exhibit 2 below). Overall, the total adjustments had the net effect of increasing the comprehensive income and expenditure account, net assets and reserves by £977,000. A number of recalculations and reallocations have also been made to the Cash Flow Statement as a result of our work but these changes did not impact on the overall financial position. There is one uncorrected misstatement to report which relates to intra-group balances of £1.239 million not eliminated on consolidation due to timing differences. This has no impact on the overall financial position. Further detail is provided in Appendix 1.

We have significant findings to report as a result of our audit

20. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures. The significant findings are summarised in Exhibit 2.

Exhibit 2
Significant findings and key audit matters from the audit of the annual accounts

Issue
1. Restricting the value of the pension asset The pension liability is an area of audit focus due to the material value and significant assumptions used within the complex calculation of this liability. In common with other local government pension scheme employers, the City of Edinburgh commissions a firm of actuaries to value its pensions liability. The actuary reported that, as at 31 March 2023, CEC did not have a liability but rather a funding surplus of £1.003 billion. The surplus arose as a result of a significant increase to the net discount rate (discount rate net of CPI inflation) compared to the previous year, leading to a large gain on the balance sheet position. At the time the accounts were prepared, technical guidance to support preparation of this disclosure was not available. Accounting standards (IAS 19 and IFRIC 14) impose a limit on the maximum amount of surplus which can be recognised on an employer's balance sheet, what is described as an 'asset ceiling'. As a result, the unaudited accounts restricted the pension asset to £597.5 million.

Issue
However, where actuaries report that the present value of the minimum funding requirement contributions exceeds the future service cost, IFRIC 14 advises that no asset should be recognised. This was the case with the council's actuarial calculations. Given that CEC is to continue to participate in the LGPS, it would be expected that this surplus could lead to lower future contributions rather than a refund of surplus. **Resolution** Following our review of the accounting standards, actuarial calculations and relevant guidance, when this minimum funding obligation is considered, it was agreed that the council's recognised asset should be reduced to zero. Most local authorities across Scotland are expected to experience the same trend in the pension liability/surplus disclosed in their audited 2022/23 accounts.
2. Valuation of council homes Council-owned dwellings are valued using the 'beacon' method, in line with relevant standards and guidance. Values of groups of similar homes are calculated by assessing the value of one of them (the beacon), then extrapolating the value across the rest of the group. That value is then adjusted to reflect differences between valuation of private housing and socially-rented housing stock. The beacon discount factor is determined by comparing levels of private rent with social rent for each beacon property and calculating the average to apply across the whole portfolio to take account of the difference between private housing stock (the source of the comparable sales data) and socially-rented stock. The discount factor applied in the 2022-23 revaluations is 38%. In the course of the valuation team considering the discount factor in 2022/23, an error in the original calculation from the 2018-19 valuation was discovered and corrected. The calculation (including yields) assumes that the value of a council dwelling is 38% of market value, however in prior years they discounted by 38% rather than using 38% as the residual value of the properties. Prior to the production of the annual accounts, officers notified us of this error and no modification was required to the audited version of the accounts. **Resolution** A prior period adjustment for 2021/22 has been recognised in the annual accounts to reduce the opening value of the council's housing stock to £1.070 billion, a reduction of £673.3 million. This has been adequately disclosed in the notes to the accounts.
3. Early adoption of IFRS 16 Leases The council has adopted International Financial Reporting Standard 16 (IFRS) for the first time in 2022/23, being one of the first local authorities in the UK to do so, one year ahead of mandatory implementation next year. The standard requires the council to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. This effectively means that

Issue
many assets which were previously leased, but not owned, have been brought on to the authority's balance sheet as a 'right of use' asset. The council has undertaken a significant amount of work since 2019 to correctly categorise current leases, to accurately reflect them in financial records and accounts, and to identify any subsequent new leases. Officers in finance have consulted with external IFRS 16 experts to effectively manage the process and calculation for the disclosures in the accounts. Our review of the accounting entries associated with adoption IFRS 16 did not identify any misstatements. **Resolution** The adoption of the standard has resulted in an additional £149.7 million net book value (NBV) to the authority’s group balance sheet recognised as ‘right of use’ assets, with an associated liability of £134.6 million.
4. Contingent liability in relation to use of RAAC concrete In December 2022, the UK government issued a notice regarding Reinforced Autoclaved Aerated Concrete (RAAC), which was widely used in the construction of floors and roofs from the 1950s to the early 1990s. The Scottish and UK governments are working to research the extent of the use of RAAC in public buildings, with significant growing public concern over its safety. In September 2023, the council named seven schools which contained RAAC and is currently assessing other public buildings. We concluded that this potential liability qualified as a contingent liability in the 2022/23 annual accounts. **Resolution** We concluded that this issue qualified as a contingent liability and consequently an appropriate disclosure has been made in the 2022/23 annual accounts.

Source: Audit Scotland

Financial systems of internal control operated effectively overall

21. As part of our audit, we identify and assess the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the body has systems for recording and processing transactions which provide a sound basis for the preparation of the financial statements. Overall, we concluded that the controls in place were satisfactory.

22. We share the concerns raised by internal audit's 2023 report on the Swift system used by the authority for social care case management. These concerns have also been raised in a recent Care Inspectorate report. Internal audit highlighted that the design and operating effectiveness of the controls in place to manage system security, data quality, and data loss prevention for the Swift system require significant improvement. A full business case for replacement of the system is timetabled for autumn 2023. We will continue to monitor the implementation of this new system during the course of our audit appointment.

Management commentary

23. The Local Authority Accounts (Scotland) Regulations 2014 requires the annual accounts to include a Management Commentary prepared in accordance with statutory guidance, including a description of the principal risks and uncertainties faced by the council. Risks have been included in the management commentary. However, the description could be more tailored to the council so that a reader can better understand why they are important and the council's response to the risk. We will work with the council to enhance disclosures in this area in next year's accounts.

Appendix 1. Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £250,000.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in Exhibit 1. We are satisfied that these errors do not have a material impact on the financial statements.

Narrative	Account areas	Comprehensive Income and Expenditure Statement		Balance Sheet	
Accounting Misstatements		**Dr** **£000**	**Cr** **£000**	**Dr** **£000**	**Cr** **£000**
1. Intra-group balances not eliminated on consolidation	Payables			1,239	
	Receivables				1,239
Total				1,239	1,239

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www.audit-scotland.gov.uk/accessibility

AUDIT SCOTLAND

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