**Audit and Risk Committee**
5 March 2019
Agenda Item No 10

**External Audit**
Report by Chief Financial Officer

**Summary:** This report appends:

(i) the Audit Plan for the 2018/19 audit
(ii) the Local Government Audit Committee Briefing by Ernst & Young.

**Recommendation:**

(i) That the Audit Plan for the 2018/19 audit be noted.

(ii) That the briefing, including the key questions for Audit Committees as set out on page 10, be noted.

## 1 Introduction

1.1 The Audit Plan for the 2018/19 audit by Ernst & Young is appended to this report (appendix 1). The plan sets out the work which the auditors propose to undertake for the audit of the financial statements and the value for money conclusion for 2018/19. It confirms that the proposed audit fee will be £10,736, which represents a deduction of £3,207 when compared to the 2017/18 audit.

1.2 The Audit Partner, Kevin Suter, has been replaced by Mark Hodgson. The Audit Manager, Vicky Chong, will be attending the meeting to introduce the Audit Plan and answer any questions.

## 2 Identification of Significant Risks

2.1 The Audit Plan takes a risk-based approach to audit planning and identifies significant risks in 2018/19, these relate to misstatements due to fraud or error. This includes the incorrect capitalisation of revenue expenditure. These risks are consistent to the risks presented for 2017/18.

2.2 Other risks identified are the valuation of land and buildings and the pension liability valuation. These are not new risks and were considered in last year's audit.

2.3 There is one new area of audit focus for 2018/19 which relates to the implementation of new accounting standards IFRS 9 Financial Instruments and IFRS 15 Revenue from contracts. The audit will assess the Authority's implementation of these in the Statement of Accounts.

2.4 The audit approach to these risks, audit focus and value for money is set out in section two and three of the Audit Plan.

## 3 Financial Implications

3.1 Provision for the audit fee is included in the 2018/19 budget and will be charged in the accounts for the year.

## 4 Briefing Key Issues

4.1 This briefing is presented to Members as a “for information” item.

4.2 The items of relevance to the Authority are:

- The government and economic news, in particular regarding the impact of low unemployment and Brexit (page 2 onwards);
- CIPFA Investment Guidance (page 4);
- Public Sector Pension Scheme Valuation (page 5);
- Local Public Audit – Expectations gap (page 5); and
- PSAA: Report on results of 2017/18 audits (page 7).

| | |
|---|---|
| Background papers: | None |
| Author: | Emma Krelle |
| Date of report: | 15 February 2019 |
| Broads Plan Objectives: | None |
| Appendices: | APPENDIX 1 – Ernst & Young Audit Plan 2018/19<br>APPENDIX 2 – Ernst & Young Local Government Audit Committee Briefing (Quarter 4 2018) |

# Broads Authority

## Audit Plan

Year ended 31 March 2019

6 February 2019

Building a better working world

The Members
Audit & Risk Committee
Broads Authority
Yare House
62-64 Thorpe Road
Norwich NR1 1RY

6 February 2019

Dear Audit & Risk Committee Members

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit & Risk Committee with a basis to review our proposed audit approach and scope for the 2018/19 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Authority, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of the Audit & Risk Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on the 5 March 2019, as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

MARK HODGSON

Mark Hodgson

Associate Partner

For and on behalf of Ernst & Young LLP

# Contents



Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/ ).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit & Risk Committee and management of Broads Authority in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit & Risk Committee and management of Broads Authority those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit & Risk Committee and management of Broads Authority for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

# 01 Overview of our 2018/19 audit strategy

# Overview of our 2018/19 audit strategy

**The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit & Risk Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.**

**Audit risks and areas of focus**

| Risk / area of focus | Risk identified | Change from PY | Details |
|---|---|---|---|
| Misstatements due to fraud or error | Fraud risk | No change in risk or focus | As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. |
| Incorrect capitalisation of revenue expenditure | Fraud risk | **No change** in risk or focus, but shown separately for clarity | Linking to the risk above we have considered the capitalisation of revenue expenditure on Property, Plant and Equipment (PPE) as a specific fraud risk, given the extent of the Authority's capital programme. |
| Valuation of Land and Buildings | Inherent risk | No change in risk or focus | The fair value of Property, Plant and Equipment (PPE) represent significant balances in the Authority's accounts and are estimates which are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. |
| Pension Liability Valuation | Inherent risk | No change in risk or focus | The Local Authority Accounting Code of Practice and IAS19 require the Authority to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Norfolk County Council.<br>The Authority's pension fund liability (£7.571 million as at 31 March 2018) is a material estimate and the Code requires that the liability be disclosed on the Authority's balance sheet. |

In addition to the risks outlined above we have identified an area of audit focus.

| Area of focus | Change from PY | Details |
|---|---|---|
| Implementation of new accounting standards | New area of focus | The 2018/19 CIPFA Code of practice on local authority accounting confirms that the Local Government will implement International Financial Reporting Standard ("IFRS") 9 – Financial Instruments and IFRS 15 – Revenue from Contracts with Customers. The Authority needs to assess and evaluate the implications of these new standards on the 2018/19 accounts. |

# Overview of our 2018/19 audit strategy

## Materiality

**Planning materiality £158,300**

Materiality has been set at £158,300 which represents 2% of the prior years gross expenditure on provision of services plus financing and investment expenditure

**Performance materiality £118,725**

Performance materiality has been set at £118,725, which represents 75% of materiality.

**Audit differences £7,915**

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement and cash flow statement) greater than £7,915. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit & Risk Committee.

## Audit scope

This Audit Plan covers the work that we plan to perform to provide you with:

- Our audit opinion on whether the financial statements of Broads Authority give a true and fair view of the financial position as at 31 March 2019 and of the income and expenditure for the year then ended; and

- Our conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Authority's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements;
- Developments in financial reporting and auditing standards;
- The quality of systems and processes;
- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Authority.

# 02 Audit risks

# Our response to significant risks

| Misstatements due to fraud or error * | What is the risk? | What will we do? |
|---|---|---|
| | The financial statements as a whole are not free of material misstatements whether caused by fraud or error.<br><br>As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.<br><br>We identify and respond to this fraud risk on every audit engagement.<br><br>Linking to our risk of fraud we have considered the capitalisation of revenue expenditure on Property, Plant and Equipment (see below). | In order to address this risk we will carry out a range of procedures including:<br>▸ Identifying fraud risks during the planning stages.<br>▸ Inquiry of management about risks of fraud and the controls put in place to address those risks.<br>▸ Understanding the oversight given by those charged with governance of management's processes over fraud.<br>▸ Consideration of the effectiveness of management's controls designed to address the risk of fraud.<br>▸ Determining an appropriate strategy to address those identified risks of fraud.<br>▸ Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements. |

**We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.**

# Our response to significant risks (continued)

**Misstatements due to fraud or error - the incorrect capitalisation of revenue expenditure ***

### Financial statement impact

We have identified a risk of expenditure misstatements due to fraud or error that could affect the income and expenditure accounts.

We consider the risk applies to capitalisation of revenue expenditure and could result in a misstatement of cost of services reported in the Comprehensive Income and Expenditure statement.

### What is the risk?

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively (see above).

As the Authority is more focused on its financial position over medium term, we have considered the risk of management override to be more prevalent in the inappropriate capitalisation of revenue expenditure on Property, Plant and Equipment (PPE) given the extent of the Authority's capital programme.

### What will we do?

In order to address this risk we will carry out a range of procedures including:

- Reviewing the appropriateness of revenue and expenditure recognition accounting policies and testing that they have been applied correctly during our detailed testing;
- Performing sample testing on additions to PPE to ensure that they have been correctly classified as capital and included at the correct value to identify any revenue items that have been inappropriately capitalised;
- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

**We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.**

# Other areas of audit focus

**We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.**

| What is the risk/area of focus? | What will we do? |
|---|---|
| Valuation of Land and Buildings<br><br>The fair value of Property, Plant and Equipment (PPE) represent significant balances in the Authority's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.<br><br>The Authority will engage an external expert valuer who will apply a number of complex assumptions to these assets. Annually assets are assessed to identify whether there is any indication of impairment.<br><br>As the Authority's asset base is significant, and the outputs from the valuer are subject to estimation, there is a risk fixed assets may be under/overstated.<br><br>ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates. | In order to address this risk we will carry out a range of procedures including:<br>▸ Consider the work performed by the Authority's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;<br>▸ Sample testing key asset information used by the valuer in performing their valuation (e.g. floor plans to support valuations based on price per square metre);<br>▸ Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;<br>▸ Review assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated;<br>▸ Consider circumstances that require the use of EY valuation specialists to review any material specialist assets and the underlying assumptions used;<br>▸ Consider changes to useful economic lives as a result of the most recent valuation; and<br>▸ Test accounting entries have been correctly processed in the financial statements. |

# Other areas of audit focus

**We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.**

| What is the risk/area of focus? | What will we do? |
|---|---|
| Pension Liability Valuation<br><br>The Local Authority Accounting Code of Practice and IAS19 require the Authority to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Norfolk County Council.<br><br>The Authority's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Authority's balance sheet. At 31 March 2018 this totalled £7.571million.<br><br>The information disclosed is based on the IAS 19 report issued to the Authority by the actuary to the County Council.<br><br>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf.<br><br>ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates. | In order to address this risk we will carry out a range of procedures including:<br>▶ Liaise with the auditors of Norfolk Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Broads Authority;<br>▶ Assess the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PwC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and<br>▶ Review and test the accounting entries and disclosures made within the Authority's financial statements in relation to IAS19. |

# Other areas of audit focus

**We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.**

| What is the risk/area of focus? | What will we do? |
|---|---|
| New accounting standards<br><br>The Code requires the Authority to comply with the requirements of two new accounting standards for 2018/19. These standards are:<br><br>• IFRS 9 – Financial Instruments<br><br>This new accounting standard will change:<br>▸ How financial assets are classified and measured;<br>▸ How the impairment of financial assets are calculated; and<br>▸ The disclosure requirements for financial assets.<br><br>There are transitional arrangements within the standard; and the 2018/19 CIPFA Code of practice on local authority accounting provides guidance on the application of IFRS 9. However, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty on the accounting treatment.<br><br>• IFRS 15 – Revenue from contracts<br><br>The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.<br><br>The 2018/19 CIPFA Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised.<br><br>The impact on local authority accounting is likely to be limited as large revenue streams like government grants and toll income will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue will change and new disclosure requirements introduced. | In order to address this risk we will carry out a range of procedures including:<br>▸ Assess the Authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standards, transitional adjustments and planned accounting for 2018/19;<br>▸ Consider the classification and valuation of financial instrument assets;<br>▸ Review new expected credit loss model impairment calculations for assets;<br>▸ Consider application to the Authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and<br>▸ Check additional disclosure requirements. |

# 03 Value for Money Risks

# Value for Money

## Background

We are required to consider whether Broads Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

For 2018/19 this is based on the overall evaluation criterion:

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

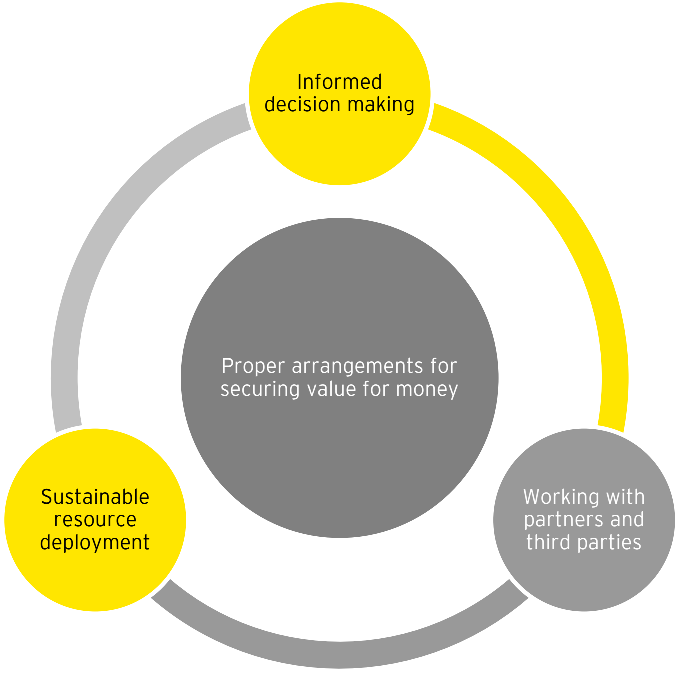
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2018/19 this has included consideration of the steps taken by Broads Authority to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Authorities will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of no significant risk which we view as relevant to our value for money conclusion.



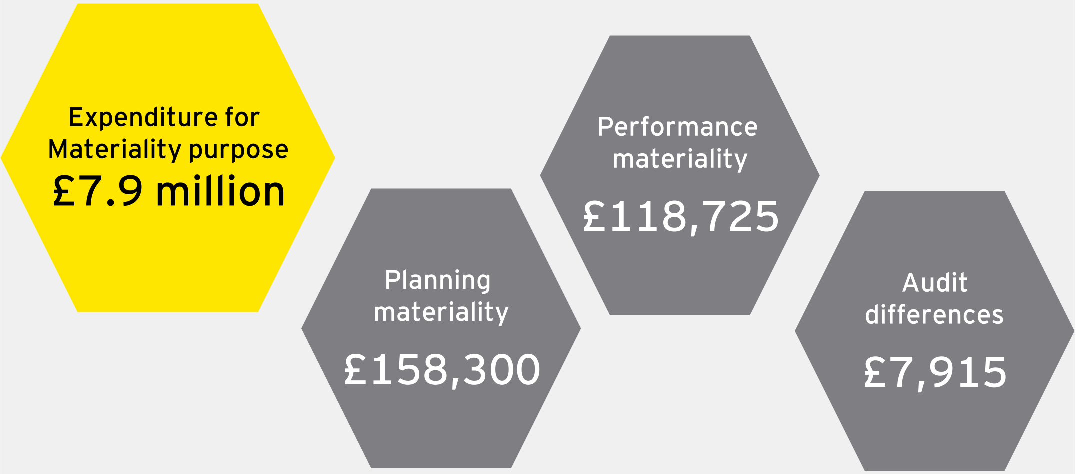
# 04 Audit materiality

# Audit materiality

## Materiality

### Materiality

For planning purposes, materiality for 2018/19 has been set at £158,300. This represents 2% of the Authority's prior year gross expenditure on net cost of services plus financing and investment expenditure. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.




We request that the Audit & Risk Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

### Key definitions

**Planning materiality –** the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

**Performance materiality –** the amount we use to determine the extent of our audit procedures. We have set performance materiality at £118,725 which represents 75% of planning materiality. We have considered a number of factors such as the number of errors in the prior year and any significant changes when determining the percentage of performance materiality.

**Audit difference threshold –** we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement and balance sheet that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Audit & Risk Committee, or are important from a qualitative perspective.

**Specific materiality** – We have set a lower materiality for Senior Officer's Remuneration, Members' Allowances and Exit Packages disclosures which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this.

# 05 Scope of our audit

# Our Audit Process and Strategy

**Objective and Scope of our Audit scoping**

Under the Code of Audit Practice our principal objectives are to review and report on the Authority's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. **Financial statement audit**

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

**Procedures required by standards**
- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- Auditor independence.

**Procedures required by the Code**
- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

2. **Arrangements for securing economy, efficiency and effectiveness (value for money)**

We are required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

# Our Audit Process and Strategy (continued)

## Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2018/19 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics:
We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit & Risk Committee.

Internal audit:
As in prior years, we will review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.

# 06 Audit team

# Overview of our 2018/19 audit strategy

## Audit team changes

Key changes to our team.

| |
|---|
| **Mark Hodgson**<br>Lead Audit Partner |
| **Vicky Chong**<br>Audit Manager |
| **Will Turner**<br>Lead Senior |

### Working together with the Authority

We are working together with officers to identify continuing improvements in communication and processes for the 2018/19 audit.

We will continue to keep our audit approach under review to streamline it where possible.

## Audit team

The engagement team is led by Mark Hodgson, who has replaced Kevin Suter to be the Lead Audit Partner. Mark has significant experience on local government audits and leads our Government & Public Sector practice across East Anglia. Mark is supported by Vicky Chong who took over the role of Audit Manager from Sappho Powell. She is responsible for the day-to-day direction of audit work and is the key point of contact for the Chief Financial Officer. The day-to-day audit team will be led by Will Turner who took over from Bach Pham as the Lead Senior of the audit. Will is a fully qualified senior who has a number of years experience in Government and Public Sector audits.

# Use of specialists

Our approach to the involvement of specialists, and the use of their work.

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

| Area | Specialists |
| --- | --- |
| Valuation of Land and Buildings | Concertus (the Authority's property valuer), EY Real Estate team (if required) |
| Pensions disclosure | EY Actuaries, PwC (Consulting Actuary to PSAA) and Hymans Robertson (the Authority's actuary) |

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Authority's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- Assess the reasonableness of the assumptions and methods used;
- Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

# 07 Audit timeline

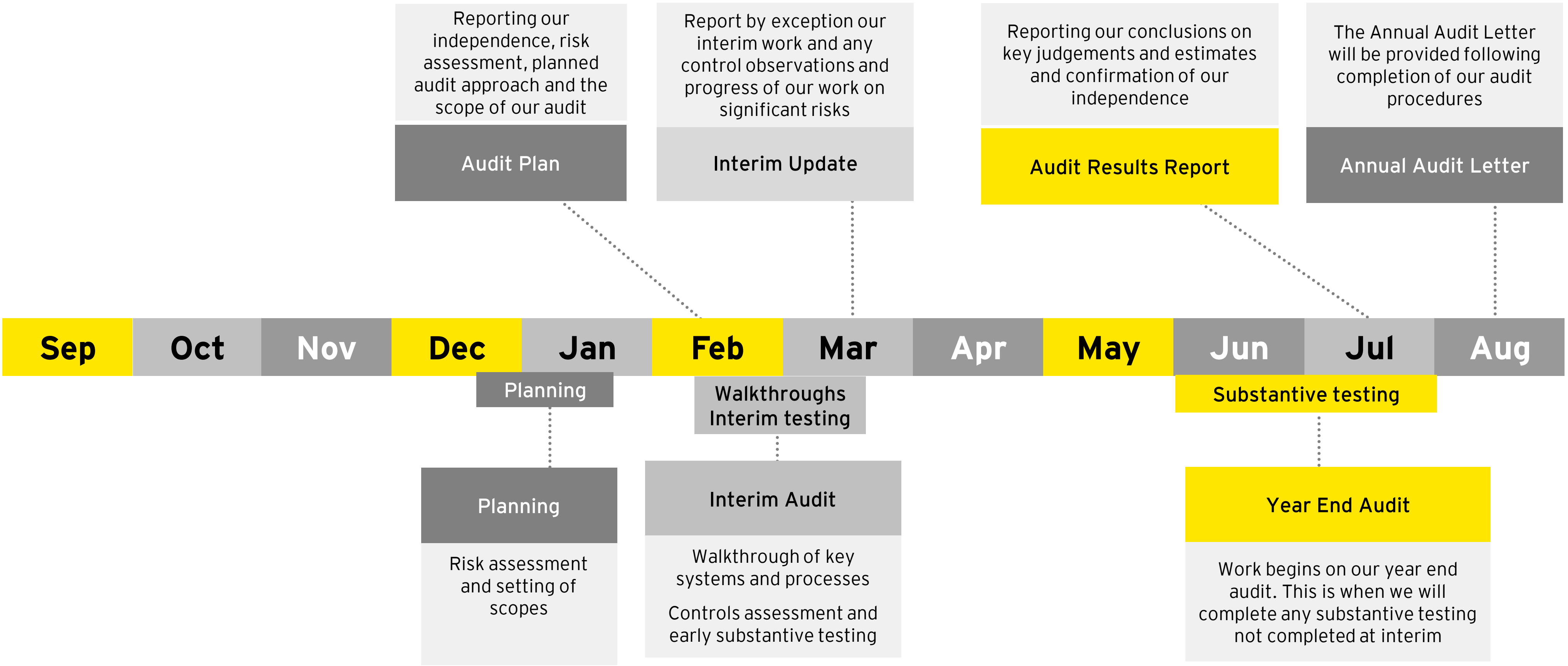
# Audit timeline

## Timetable of communication and deliverables

### Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle 2018/19.

From time to time matters may arise that require immediate communication with the Audit & Risk Committee and we will discuss them with the Audit & Risk Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.



# 08 Independence

# Independence

## Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate.  The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

| Required communications | |
| --- | --- |
| **Planning stage** | **Final stage** |
| ▸ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;<br>▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;<br>▸ The overall assessment of threats and safeguards;<br>▸ Information about the general policies and process within EY to maintain objectivity and independence.<br>▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard [note: additional wording should be included in the communication reflecting the client specific situation] | ▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create.  We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed;<br>▸ Details of non-audit services provided and the fees charged in relation thereto;<br>▸ Written confirmation that the firm and each covered person is  independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us;<br>▸ Written confirmation that all covered persons are independent;<br>▸ Details of any inconsistencies between FRC Ethical Standard and your  policy for the supply of non-audit services by EY and any apparent breach of that policy;<br>▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and<br>▸ An opportunity to discuss auditor independence issues. |

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements , the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

# Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non –audit services if the service has been pre-approved in accordance with your policy.

## Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Mark Hodgson, your audit engagement partner and the audit engagement team have not been compromised.

## Self interest threats

A self interest threat arises when EY has financial or other interests in the Authority. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

There are no other self interest threats at the date of this report.

## Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self review threats at the date of this report.

## Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Authority. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

## Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

# Other communications

| EY Transparency Report 2017 |
| --- |
| Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.<br>Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2018 and can be found here:<br>https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018 |

# 09 Appendices

# Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government.

PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code.

| | Planned fee 2018/19 | Scale fee 2018/19 | Final Fee 2017/18 |
|---|---|---|---|
| | £'s | £'s | £'s |
| Total Fee – Code work | 10,736 | 10,736 | 13,943 |
| Total fees | 10,736 | 10,736 | 13,943 |

***All fees exclude VAT***

The agreed fee presented is based on the following assumptions:

- ► The level of risk in relation to the financial statements and VFM arrangements remains the same;
- ► Officers meeting the agreed timetable of deliverables;
- ► Our accounts opinion and value for money conclusion being unqualified;
- ► Appropriate quality of documentation is provided by the Authority; and
- ► The Authority has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Authority in advance.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

# Appendix B

## Required communications with the Audit & Risk Committee

**We have detailed the communications that we must provide to the Audit & Risk Committee.**

| Required communications | What is reported? | Our Reporting to you: When and where |
|---|---|---|
| Terms of engagement | Confirmation by the Audit & Risk Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties. | The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies. |
| Our responsibilities | Reminder of our responsibilities as set out in the engagement letter | The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies. |
| Planning and audit approach | Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.<br>When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team | Audit Plan - February 2019 |
| Significant findings from the audit | ▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures<br>▸ Significant difficulties, if any, encountered during the audit<br>▸ Significant matters, if any, arising from the audit that were discussed with management<br>▸ Written representations that we are seeking<br>▸ Expected modifications to the audit report<br>▸ Other matters if any, significant to the oversight of the financial reporting process | Audit Results Report – July 2019 |
| Going concern | Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:<br>▸ Whether the events or conditions constitute a material uncertainty<br>▸ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements<br>▸ The adequacy of related disclosures in the financial statements | Audit Results Report – July 2019 |

# Appendix B

## Required communications with the Audit & Risk Committee

| Required communications | What is reported? | Our Reporting to you — When and where |
|---|---|---|
| Misstatements | ► Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation<br>► The effect of uncorrected misstatements related to prior periods<br>► A request that any uncorrected misstatement be corrected<br>► Corrected misstatements that are significant<br>► Material misstatements corrected by management | Audit Results Report – July 2019 |
| Fraud | ► Enquiries of the Audit & Risk Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity<br>► Any fraud that we have identified or information we have obtained that indicates that a fraud may exist<br>► A discussion of any other matters related to fraud | Audit Results Report – July 2019 |
| Related parties | ► Significant matters arising during the audit in connection with the entity's related parties including, when applicable:<br>► Non-disclosure by management<br>► Inappropriate authorisation and approval of transactions<br>► Disagreement over disclosures<br>► Non-compliance with laws and regulations<br>► Difficulty in identifying the party that ultimately controls the entity | Audit Results Report – July 2019 |
| Independence | Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence<br>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:<br>► The principal threats<br>► Safeguards adopted and their effectiveness<br>► An overall assessment of threats and safeguards<br>► Information about the general policies and process within the firm to maintain objectivity and independence. | Audit Plan – February 2019; and<br><br>Audit Results Report – July 2019 |

# Appendix B

## Required communications with the Audit & Risk Committee

| | | Our Reporting to you |
|---|---|---|
| **Required communications** | **What is reported?** | **When and where** |
| External confirmations | ▸ Management's refusal for us to request confirmations<br>▸ Inability to obtain relevant and reliable audit evidence from other procedures | Audit Results Report – July 2019 |
| Consideration of laws and regulations | ▸ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off<br>▸ Enquiry of the Audit & Risk Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit & Risk Committee may be aware of | Audit Results Report – July 2019 |
| Internal controls | ▸ Significant deficiencies in internal controls identified during the audit | Audit Results Report – July 2019 |
| Representations | Written representations we are requesting from management and/or those charged with governance | Audit Results Report – July 2019 |
| Material inconsistencies and misstatements | Material inconsistencies or misstatements of fact identified in other information which management has refused to revise | Audit Results Report – July 2019 |
| Auditors report | ▸ Key audit matters that we will include in our auditor's report<br>▸ Any circumstances identified that affect the form and content of our auditor's report | Audit Results Report – July 2019 |
| Fee Reporting | ▸ Breakdown of fee information when the audit plan is agreed<br>▸ Breakdown of fee information at the completion of the audit<br>▸ Any non-audit work | Audit Plan – February 2019<br>Audit Results Report – July 2019 |

# Additional audit information

| Other required procedures during the course of the audit | |
|---|---|
| In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit. | |
| Our responsibilities required by auditing standards | ▸ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.<br>▸ Obtaining an understanding of internal control relevant to the audit 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 the Authority's internal control.<br>▸ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.<br>▸ Concluding on the appropriateness of management's use of the going concern basis of accounting.<br>▸ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.<br>▸ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Authority to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Audit & Risk Committee reporting appropriately addresses matters communicated by us to the Risk & Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and<br>▸ Maintaining auditor independence. |

# Appendix C

## Additional audit information (continued)

### Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

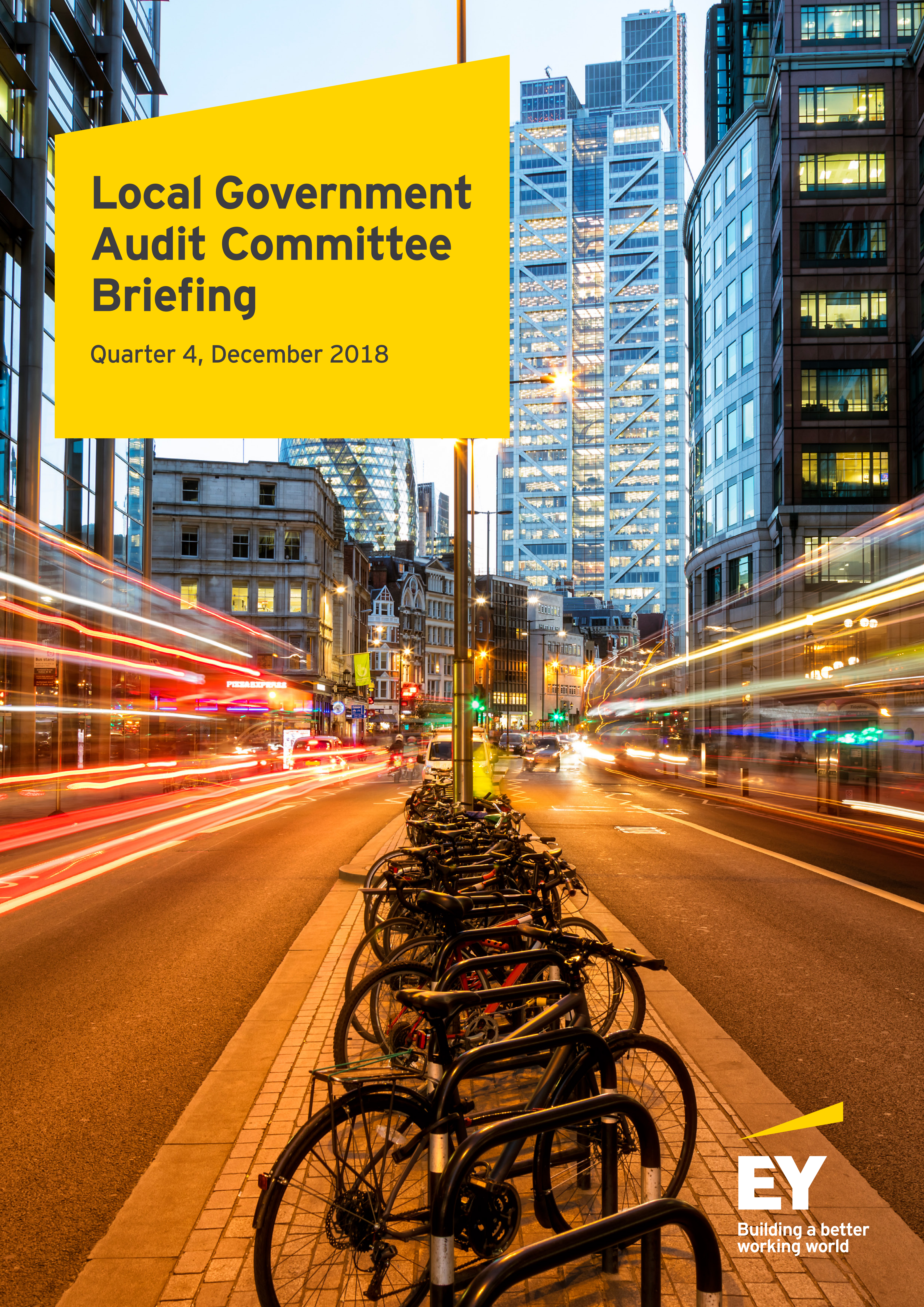
Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

# Local Government Audit Committee Briefing

Quarter 4, December 2018



Building a better working world

# Contents at a glance

This sector briefing is one of the ways that we support you and your organisation in an environment that is constantly changing and evolving.

It covers issues which may have an impact on your organisation, the Local Government sector, and the audits that we undertake.

The briefings are produced by our public sector audit specialists within EY's national Government and Public Sector (GPS) team, using our public sector knowledge, and EY's wider expertise across UK and international business.

The briefings bring together not only technical issues relevant to the Local Government sector but wider matters of potential interest to you and your organisation.

Links to where you can find out more on any of the articles featured can be found at the end of the briefing.

We hope that you find the briefing informative and should this raise any issues that you would like to discuss further, please contact your local audit team.

# Government and economic news

## EY Club Item

The latest EY ITEM Club forecast casts a cloudier outlook for the UK economy which will have implications for Local Authorities. This partly reflects increased uncertainties about Brexit, due to the elevated risk of the UK leaving the EU without a deal. It also reflects a more challenging global outlook, and continued pressures on consumer purchasing power.

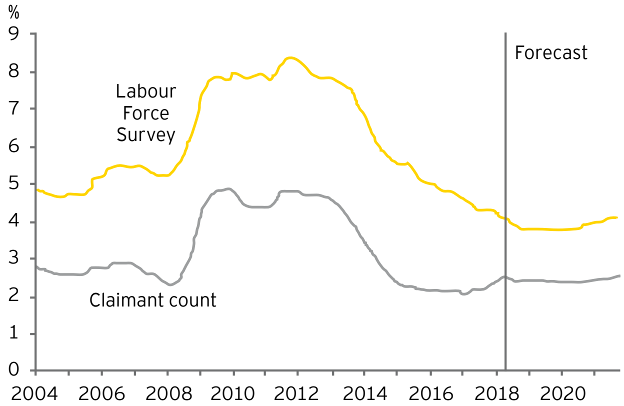
The forecast has slightly downgraded the UK's economic prospects for 2018 and 2019, with GDP growth for 2018 trimmed from 1.4% to 1.3% — the slowest rate of expansion since 2009. While performance improved in Q2 and Q3, the outlook has since become less certain.

One positive note for UK economy is the robust growth in labour demand. The unemployment rate remained at 4.0% for the three months to July, the lowest level since February 1975. Over the same period, the number of vacancies in the UK rose to 833,000, highlighting the tightness in the labour market.

As shown in Figure 1, it appears that the spare capacity in the labour market created during the crisis has been largely absorbed. The Bank of England's (BoE) recent report about the labour market suggests that very limited slack remains — a BoE's regional Agents survey found that 40% of companies are finding it harder to recruit and retain staff compared to last year.

Figure 1

**UK: Unemployment rate**




Source: EY ITEM Club

The recruitment challenges facing employers are well known by local authorities. An expanding and ageing population will only add to the demand pressures, while the supply of workers may be at risk due to the impact of Brexit on migration of EEA workers.

Theory suggests that, with unemployment falling and vacancies rising, there is little scope for further labour market tightening without generating excess wage pressures. However, earnings growth has remained subdued in recent periods, and indeed relapsed in Q2 2018. Some firms appear keen to limit their costs in an uncertain environment, while fragile consumer confidence is likely deterring workers from pushing hard for pay rises.

These consumer pressures are manifesting in many areas of the economy, and notably in the housing market. Caution over engaging in major transactions has seen mortgage approvals at approximately 18.1% below their long-term (1993–2018) average. Given the earnings squeeze, and the faltering demand for private housing, the important role of social housing is likely to persist. There were 1.2 million households on a waiting list for social housing in England on 1 April 2017, exhibiting the significant excess demand. As a result, the announcement by the Government to scrap the HRA borrowing cap is welcome, and should go some way to meeting demand in the market.

## As Brexit beckons, what is the impact that local authorities can expect across the UK?

With increasing focus on a potential extension to the Brexit transitionary period and the likelihood of a 'no-deal' scenario failing to diminish, local authorities are beginning to prepare for an array of potential impacts from the UK's departure from the EU. We look below at some of the key focus areas for local government in assessing the impact of Brexit.

### The impact on social care provision:

The social care workforce is particularly susceptible to the impact of Brexit. Since the referendum in 2016, there has already been a decrease in the number of EU nationals taking jobs in the UK social care sector, and this is likely to be squeezed further with the end of freedom of movement. This has the potential to lead to labour cost inflation, increasing the financial pressure facing local authorities.

The effects described above will be exacerbated further due to challenges in the healthcare system. The NHS is similarly likely to suffer to workforce challenges and hence, funding challenges. This has the potential to increase the pressure on hospitals to discharge early, increasing the burden on the social care system's capacity. The government's winter crisis cash pledge to the system, is unlikely to mitigate such challenges.

### The impact on supply chains and logistics:

Some coastal local authorities may face years of road traffic issues if border checks are applied following Brexit; authorities in the South East likely to be most significantly affected, due to the potential of border checks being applied at Dover.

Furthermore, investigations have been made by authorities such as Pembrokeshire Council into the ready availability of food and medicine in the event of road blockages and closures. Additionally, local authorities are struggling to make plans around international trade, as they await information on charges and how long waiting times at ports are likely to be. This is particularly important in the case of livestock and fresh foods being transported.

Changes to customs unions and physical borders may reduce the availability and increase the price of key goods required by local authorities, including adult social care supplies.

### Consumer demand:

Brexit will impact the wider economy, and hence local authorities will need to be attuned to the impact on their local economies.

Brexit uncertainty is already beginning to influence the high street and local authorities need to consider the prospect of increasing voids. Furthermore, local economies that are heavily dependent on certain sectors that are vulnerable to the impact of Brexit, such as financial services and agriculture, may bear a greater brunt of the economic shock that Brexit may cause.

Local authorities may also be impacted more directly, especially those authorities that have embarked enthusiastically on commercial property investments, thereby creating direct exposure to certain sectors, especially the retail sector. In respect of this, CIPFA have issued a warning to councils outlining concerns over their commercial activity, suggesting that some have been guilty of putting public funds at 'unnecessary or unquantified risk'. Councils need to evaluate the proposed impact that they were hoping such investments may have on their financial position, along with other trading activity, in light of the potential economic impact of Brexit.

### Impact on property and agricultural land prices.

Predictions that property prices in general are likely to fall following Brexit are well documented. Bank of England Governor Mark Carney has stated that UK house prices may fall by up to a third in the event of a 'no-deal' Brexit.

A reduction in property prices may not be perceived to be a bad outcome for all. Furthermore, the government's HRA borrowing cap announcement has the potential to allow councils to increase the supply of housing, further supporting a challenged housing market. However, such a reduction in property values is likely to create a shock that may create financial hardship for many as well as impacting the performance of certain sectors.

## Budget 2018

On 29 October 2018 the Chancellor delivered the 2018 Autumn Budget to Parliament. Among the headline policy announcements, such as a new 2% tax on revenue for large digital companies, changes to the income tax threshold bands, and increase in funding to help departments prepare for Brexit, there were a number of announcements that will have a direct impact on local authorities. These key announcements include:

- Immediate abolition of the Housing Revenue Account (HRA) cap which restricts local authority borrowing for house building.
- £675mn Investment in the Future High Street Fund created to support local areas prepare long term strategies for their high streets and town centres, including investment in physical infrastructure. As part of this announcement, small retail businesses will see a 33% decrease in business rates and public lavatories will receive 100% business rate relief after April 2019.
- Increased staff costs for local authorities; as the national living wage is set to increase by 5% from £7.83 to £8.21 an hour.
- Allocation of additional £420mn to local authorities in 2018/19 to tackle potholes and repair damaged roads.
- Local authorities in England will receive a further £650mn in social care funding.

CIPFA's response to the budget was that while the additional short term support for the provision of services is welcomed, there are greater long term challenges that need to be addressed to embed sustainable funding. The July 2018 OBR's (OBR) projection, upon which the budget was based, forecasts that within 50 years the UK will not be able to afford anything more than debt interest, health, social care and pension payments. CIPFA is clear that there is not sufficient funding to sustain expectations of public services at the current levels of taxation.

The Local Government Association (LGA) analysis has estimated that local services face a funding gap of £7.8bn by 2024/25; the funding gap as of 2019/20 is estimated to be £3.9bn. The services where there are the greatest funding pressures include social care, homelessness and public health. However, the growing demand for these services has detrimentally impacted on other services that help maintain local communities including libraries, roads and welfare support.

An unexpected announcement made by Government during the budget was that it will no longer use Private Finance Initiative (PFI) schemes, or its successor PF2, because PFI schemes have been identified by the Office for Budget Responsibility (OBR) as a source of significant fiscal risk to the Government. It is unclear if this decision by central Government will impact on local authorities in future years.

## CIPFA Investment Guidance

The media spotlight and public scrutiny surrounding local government finances has increased significantly over the past year due to increased pressures to deliver services from reduced funding. To help authorities better manage their finances CIPFA is updating its guidance on Treasury Management. The new key principle of guidance will be that 'Local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed'.

During 2017/18 the rate at which English councils acquired land and buildings increased by 43% to a total of £4bn; whereas total borrowing increased from £4bn to £10bn (127 %). As such there is a growing concern that too many local authorities are investing heavily in commercial property at a rate that is disproportionate to their available resources. This exposes public funds to unquantified risks. This stands against the primary objective of a local authority's treasury management strategy to safeguard public money.

# Accounting, auditing and governance

## IFRS 9: Statutory Override update

The 2018/19 financial year will be the first year where the accounting standard IFRS 9 will be implemented by local government. IFRS 9 impacts on an authority's financial assets: the investments it holds; the amounts it has lent to others; and other monetary based assets it may have. It changes how these financial assets are classified and how movements in their value are accounted for. It also changes how these assets are impaired; based on the risk that the assets may not be recovered in full, or at all.

Following a consultation by the Ministry for Housing Communities and Local Government on the impact of IFRS 9, an initial statutory override has been granted for five years, despite 90% stakeholders opposing a time-limited period. This statutory override means that councils will still be required to account for fair value movements in financial instruments (in accordance with proper practices as set out in the code on local authority accounting); however these movements will not be charged to the revenue account.

The result of which is that statutory override will remove the potential burden that council tax payers or local authorities may have faced if fair value movements were unfavourable.

## Public Sector Pension Scheme Valuation

The Government undertakes a valuation of public service pension schemes every four years, this year sees the first full assessment of these since the introduction of reformed schemes in 2015.

The Chief Secretary to the Treasury has stated that early indications would suggest that employers' contribution will need to increase as a result of a proposed decrease in the discount rate. The discount rate, known as the SCAPE rate, is based on the OBR projection of the short-term pay growth in terms of GDP. OBR has reduced this rate from 3.0% to 2.8% in 2016 and a further reduction has been proposed as of April 2019 to 2.4%. This discount rate is used to calculate the current costs of future payments and as the discount rate decreases, the pension liability increases. Given that employee rates are effectively fixed under scheme regulations, employer contributions will need to increase to meet the increased liability. Further details are to be announced later in the year in addition to further discussion taken forward as part of the spending review.

## Local Public Audit – Expectations gap

For the public to gain trust and confidence in public spending, a framework of accountability, transparency, governance and ethics needs to be built. The ultimate responsibility lies with the government departments that delegate spending to local public bodies. These public bodies must then be able to demonstrate that the money has been spent efficiently and effectively.

One way the public can gain trust in public spending, is by relying on the external audit process to provide assurance on the financial statements and report by exception on the arrangements the public body has in place to secure economy, efficiency and effectiveness. However, the role of audit, is often misunderstood creating the audit expectation gap which is the difference between what an auditor actually does, as required by legislation and auditing standards, and what stakeholders think that the auditors' obligations might be and what they might do.

The Institute of Chartered Accountants in England and Wales (ICAEW) produced a report to raise awareness on the expectation gap and suggest some possible solutions. The report also discusses how issues faced by local public bodies such as financial difficulties, increasing demand from an ageing population, complex structures and weaknesses of accountability impacts the audit process and widens the expectation gap.

Some common concerns were noted in the report by interviews with Chief Financial Officers in different sectors and regulatory bodies:

1. Local authorities and health bodies are facing a difficult time with increasing pressure to deliver more services, become innovative and commercial with reduced financial support. This pressure could bring in concerns about behaviours that may not be in the best long-term interests of the public.
2. Reports produced by auditors are not being fully utilised by management and audit committees to build on successes and make improvements within the body where recommendations have been made.
3. Auditors are concerned that qualifications and issues identified in their opinions are not taken seriously enough by those charged with governance.
4. The reduction in audit fees has led to a perception by local bodies that they are receiving reduced scope of work compared to the previous regime (Audit Commission). The concerns are not in relation to compliance with auditing standards, but rather the lack of value added activities that was previously provided.
5. Chief Financial Officers expect more challenge and review of their forward-looking plans which underpin the financial resilience of the authority.
6. Other stakeholders are not getting sufficient assurance over the effectiveness of service delivery and performance in auditors' work.
7. Increased regulation and scrutiny against the reduced number of auditor firms in the local government market.
8. Local public auditors' power being limited by the removal of indemnity insurance and increased difficulty to recover costs.

The ICAEW has offered a number of potential solutions in the report to close this expectation gap including:

1. Chief Financial Officers could consider involving external support to assist them in their financial resilience work, such as challenging their budget assumptions and other key decision making factors, instead of relying on external auditors to provide other value added activities, as these may have some independence restrictions.
2. More broadly, consideration could be given to widen the scope of the audit to include for example a greater future-looking focus.

# Regulation news

## PSAA: Report on results of 2017/18 audits

PSAA (Public Sector Accounts Appointments) has reported its annual summary on the timeliness and quality of financial reporting in relation to audits for the 2017/18 financial year. A total of 431 (87 %) local government and fire authorities published their audited accounts by the deadline of 3 July 2018. 2017/18 was the first year that the accounts and audit deadline was brought forward from the 30 September to the 31 July. PSAA's Chief Officer stated that whilst these results were encouraging and reflect considerable efforts of both local government finance staff and auditors, there is still more work to be done in order for 100% of authorities to meet the new deadline.

The number of qualified 'Value for Money' conclusions is currently at 7% (compared to 8% for 2016/17); however there 30 conclusions still to be issued for 2017/18. The most common reasons for issuing a qualified Value for Money conclusion were corporate governance issues, financial stability concerns and contract management issues.


# Other

## EY 2018 Transparency Report

Our profession has come under scrutiny from policymakers and other stakeholders over the year, and the need for transparency has never been greater. Increasingly, the public is expecting more and more from the audit than its current remit requires. This difference is known as the 'audit expectation gap' which has been discussed above. We believe the time is right for all concerned in the corporate control ecosystem to seize the moment and consider deeply what society expects from businesses and the assurance it needs over their activity.

It's in our interests and the public's for EY UK to be as open and transparent as possible. The Transparency Report goes some way towards helping us achieve this, while also providing an opportunity to share a more balanced perspective on what we do and how we perform as a business. For example, it refers to our role in building trust and confidence in the capital markets and wider economies, by maintaining and developing positive relationships with our stakeholders. It explains what we do to make a difference to people's lives by helping to improve social mobility in the UK. It also shows how our people are supported in their role as auditors by making reference to our tools, technologies and training programmes. Details on internal and external surveys and inspections are included as well, to show how we are performing against our own expectations and — most importantly — those of our regulators.

We refer to this report in our audit planning reports to audit committees, and we summarise the key headlines below.

# 2018 Highlights

## Audit quality

### External review


82% of EY's FTSE 350 audits and 67% of all inspected audits required no more than limited improvements

(FY17: 92% and 88% respectively)

as at 29 October 2018

No FRC fines for audit work completed in the last five years and no sanctions against EY UK partners in respect of that period

### Internal review

108 engagements reviewed in FY18, covering 47% of our **Responsible Individuals**, of which 81% had no improvements or minor improvements only

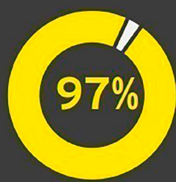
### Delivery

Of our people in Audit


96% consider delivering quality audits a priority

and

97% understand their role as an auditor in providing independent assurance, supporting strong capital markets and protecting the public interest




The result of the FRC's most recent review of out audits showed that 82% of our FTSE 350 audits were graded as requiring no more than limited improvement, against a 90% target. Overall 67% of all EY UK's audits inspected were graded as requiring no more than limited improvements. We are proud of the progress we have made in the UK since the launch of UK Sustainable Audit Quality (SAQ) programme a few years ago. But there is still more work to be done to consider audit quality from the viewpoint of key stakeholders: investors, audit committees, companies, regulators and our people. The work we have done to model the behaviours of our highest performing teams, using cognitive psychologists, will continue. In the year ahead we will prioritise the extent and consistency of the model's adoption. We aim to transform the behaviours that feature in the model into business-as-usual activity across all of our audit teams.

As organisations become more complex, so do audits, making access to different skills and capabilities more important than ever. The traditional audit has already been transformed by the use of technology and digital platforms, and the pace of change will only accelerate. These new capabilities enable us to search, sift and sort through large quantities of data, allowing us to identify potential areas of risk and understand an organisation's performance at a more granular level. The audit process is becoming more forward looking, with a focus on anticipating future risks. Our new capabilities are also providing insights into areas that were once thought to be impossible to measure, such as culture.

This unprecedented scrutiny and demand for change, can be seen as an incredible opportunity to focus our efforts on addressing the root cause, deliver sustainable high quality audit and gain the trust and confidence in the capital markets society needs and demands.

# Key questions for the Audit Committee

### 2018 Budget

How has the 2018 Budget impacted the local authority's financial plans for the current year and the year ahead?

### CIPFA Investment Guidance

How much is your authority dependent on commercial investment income to fund services?

What governance structures are in place to ensure that the authority's borrowing is proportionate to its need and level of resources?

### IFRS 9: Statutory Override

Have you considered the impact of the new IFRS 9 accounting standard? How will you plan for the possibility that the statutory override will end in five years' time?

### Public Sector Pension Scheme Valuation

Have you taken into account the impact of the most recent review of the public sector pension scheme on your budgets and medium term financial position?

### Local Public Audit – Expectations gap

How far do you recognise the issues of the ICAEW report on the expectations gap in local public audit? What is your perspective on the value that external audit provides?

### PSAA: Report on results of 2017/18 audits

What lessons have you learnt from the earlier accounts and audit deadlines in 2017/18? Are you confident that these lessons will be applied for the 2018/19 accounts and audit process?

# Find out more

## EY Club Item

https://www.ey.com/uk/en/issues/business-environment/financial-markets-and-economy/item---forecast-headlines-and-projections

### 2018 Budget

https://www.gov.uk/government/news/budget-2018-24-things-you-need-to-know

https://www.local.gov.uk/about/news/lga-responds-budget-2018

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