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Southend-on-Sea Borough Council

Audit planning report to the Audit Committee for the year ended 31 March 2021

Issued 19 April 2021 for the meeting on 28 April 2021

Contents

01 Planning report

Introduction	3
Our audit explained	5
Scope of our work	6
Covid-19 pandemic and its impact on our audit	8
Materiality	10
Audit considerations regarding the Group Accounts	11
Continuous communication	12
Significant risks	14
Value for Money	18
Reporting Hot Topics	19
Revisions to auditing standards	20
Purpose of our report and responsibility statement	23

02 Appendices

Appendix 1 - Fraud responsibilities and representations	24
Appendix 2 - Independence and fees	26
Appendix 3 – Our approach to quality	28

Introduction

The key messages in this report:

We have pleasure in presenting our planning report to the Audit Committee for the 2020/21 audit. We would like to draw your attention to the key messages of this paper:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the statement of accounts.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

Overall introduction and setting the scope of our work	Covid-19 continues to be hugely impactful for the audit of local authorities. At one level, there has been significant upheaval to Council finances through 20/21 as bodies have had to adjust spend to respond to the pandemic and as additional funding initiatives and grants have been announced. This will require additional audit work to risk assess and test these new areas of income and expenditure, many of which diverge from original budgets. At another level, our ways of working and conducting an audit continue to be impacted. We anticipate again delivering the audit remotely using online tools to facilitate collaboration. We include additional commentary on the impact of Covid-19 later in this report. Due to the impact of the pandemic, in the prior year, the deadline for submission of audited Council accounts was extended to 30 November 2020. Southend had the accounts signed on 20 October 2020. For 20/21 the current provisional deadline is set as 30 September 2021 (although this may still be subject to further extension) and it is not expected to return to the original 31 July deadline in the near future. At the same time, this is a year of substantial change to our responsibilities in relation to Value for Money ("VFM") with the roll out of AGN 03 by the National Audit Office. There is more detail on this overleaf and later in this paper. Aside from the issues noted above, our audit work will continue to be carried out in accordance with the requirements of the Code of Audit Practice ('the Code') and supporting guidance published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General. The Code sets the overall scope of the audit which includes an audit of the accounts of the Council and work to satisfy ourselves that the Council has made proper arrangements to secure value for money (VFM) in its use of resources. Our responsibilities as auditor, and the responsibilities of the Council, are set out in *"PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies",* published by Public Sector Audit Appointments Limited.
Areas of focus in our work on the accounts	At the date of this report, our planning, risk assessment and fraud enquiry procedures are in progress. We have met with key officers, reviewed financial information and progressed our interim audit. Based on procedures performed to date, we summarise overleaf the areas of significant audit risk we have so far identified, these may be subject to change following completion or our remaining planning work. We will update the Audit Committee on any changes to our risk assessment at the next Audit Committee meeting.

Areas of focus in our work on the accounts continued	• Valuation of properties – there is significant judgement over subjective inputs to the valuation. We note that the Council's housing stock is in scope for full revaluation this year and have already engaged our Council Dwelling specialist within Deloitte Real Estate to commence our work in this area. Due to the use of beacon values and the substantial value of the Council's housing stock – carrying value of £375m as at 31 March 2020 – this will be significant risk for our audit. We note that RICs standards no longer require material uncertainties due to Covid-19 in relation to property valuation to be disclosed . • Capitalisation of expenditure – there is judgement over the appropriate classification of spend as capital and not revenue. This can lead to in-year expenditure being depreciated over time instead of being recognised and expensed fully. This provides an incentive to inappropriately classify spend as capital which does not meet the accounting criteria for classification as such. • Management override of controls – auditing standards presume there is a risk that the accounts may be fraudulently misstated by management overriding controls. Key areas of focus are: bias in the preparation of accounting estimates; inappropriate journal entries; and transactions which have no economic substance. Auditing standards also presume there is a risk of fraud in revenue recognition. Following an update to our analysis of the Council's income streams, we plan to continue to rebut this presumption. The key factors considered include: the amount of annual income from each source; the transaction size; the extent of any estimates; and the complexity of the recognition principles. Our conclusion is the same as that reached last year.
Areas of focus in our work on VFM	The National Audit Office has issued a revised Code of Audit Practice for 2020/21, and a revised approach to "Value for Money" work under Audit Guidance Note 03 ("AGN03"). AGN03 adds a regime of narrative reporting to our work on value for money and leads to a new, publically issued "Annual Auditor's Report" issued at the same time as the audit opinion. The Code and supporting auditor guidance note require us to perform a risk assessment and to carry out further work where we identify a significant risk. Our risk assessment to determine whether there are any significant risks is at an early stage. We have received a summary back from officers reflecting their view on the arrangements in place. We expect to carry out the majority of our risk assessment procedures throughout April and May 2021. We will then perform update procedures in June, in particular to update for the findings of internal audit work completed in the latter part of the year, outturn performance against financial and operational metrics including the Medium Term Financial Strategy and the outcome of any findings from the work of regulators. Please note, we issued an unqualified VFM conclusion in both 2019/20 and 2018/19.
Other regulatory changes	The audit approach also reflects changes to International Standards on Auditing (UK) related to management estimates (ISA (UK) 540) and to going concern (ISA (UK) 570) and effective for this year. Also related to going concern, there is a revised Practice Note 10 effective for this year. This guidance assists auditors in their assessment of going concern on audits of financial statements in the Public Sector. IFRS 16, Leases, will apply from 1 April 2022, and will require disclosure in the 2020/21 financial statements of the expected impact on transition.
Housing Benefit Assurance Procedures	We reported to DWP in regard to the 2019/20 Housing Benefit Claim on 29 March 2021 having been granted a deadline extension from 31 January 2021. Our report including findings has been included with the papers distributed for this Audit Committee. This was our final year performing this work for the Council.

Craig Wisdom
Audit Partner

Our audit of the statement of accounts explained

We tailor our audit to your Authority

Identify changes in your business and environment

Covid-19 has been hugely impactful for local authorities including for Southend. We anticipate this leading to some changes in final outturn versus budget and new components of income and expenditure that will require a refreshed audit approach. The Council also has some major capital projects planned.

Scoping

Our work will be carried out in accordance with the Code of Audit Practice and supporting auditor guidance notes issued by the NAO.

More detail is given on the following page.

In our final report

In our final report to you we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report, including key audit matters if applicable.

Determine materiality

We have determined planning materiality to be £7.7m (2019/20: £7.6m). This is based on 2% of 2019/20 gross expenditure. We will report to you all misstatements in excess of the clearly trivial threshold of £390k (2019/20: £385k). We may revise materiality once we have the final outturn figures and will advise the Audit Committee of any change accordingly.

Significant risk assessment

We have identified the appropriate capitalisation of expenditure and property valuations as significant risks

We discuss significant risks on pages 14-17.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of Southend-on-Sea Borough Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Scope of work and approach

We have the following areas of responsibility under the Code

Opinion on the Council's financial statements

We will conduct our audit in accordance with the Code of Audit Practice and supporting guidance issued by the National Audit Office ("NAO") and International Standards on Auditing (UK) ("ISA (UK)") as adopted by the UK Auditing Practices Board ("APB").

We report on whether the financial statements:

- Give a true and fair view of the financial position and income and expenditure
- Are prepared properly in accordance with the Code of Practice on Local Authority Accounting ("the Code").

Opinion on other matters

We are required to report on whether other information published with the audited financial statements is consistent with the financial statements.

Other information includes information included in the statement of accounts, in particular the Narrative Report. It also includes the Annual Governance Statement which the Council is required to publish alongside the Statement of Accounts.

In reading the information given with the financial statements, we take into account our knowledge of the Council, including that gained through work in relation to the body's arrangements for securing value for money through economy, efficiency and effectiveness in the use of its resources.

Whole Government Accounts

We are required to issue a separate assurance report on the Council's separate return required to facilitate the preparation of the Whole of Government Accounts. The impacts of Covid-19 on this process are not yet clear although the overall view seems to be this consolidation is required. Our work on the return is carried out in accordance with instructions issued by the NAO and typically focuses on testing the consistency of the return with the Council's financial statements, together with the validity, accuracy and completeness of additional information about the Council's transaction and balances with other bodies consolidated within the Whole of Government Accounts. We are also typically asked to report to the NAO on key findings from our audit of the accounts. The NAO has not yet issued its instructions for the current year.

Value for Money conclusion

We are required to consider the arrangements that the Council has made securing financial resilience and economy, efficiency and effectiveness in its use of resources, if we identify any significant weaknesses to make recommendations, and to provide a narrative commentary on arrangements.

To perform this work, we are required to:

- Obtain an understanding of the Council's arrangements sufficient to support our risk assessment and commentary;
- Assess whether there are risks of a significant weakness in the Council's arrangements, and perform additional procedures if a risk is identified. If a significant weakness is identified, we report this and an accompanying recommendation;
- Report in our audit opinion if we have reported any significant weaknesses.
- Issue a narrative commentary in our Annual Auditor's Report on the arrangements in place.

This will require a minimum level of work at every local public body, with additional risk based work where relevant.

Our responsibilities as auditor, and the responsibilities of the Council, are set out in "PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies", published by PSAA

Scope of work and approach

Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We plan to meet with the Head of Internal Audit to discuss the internal audit work performed and we will review the internal audit reports issued in the period. We will consider the findings from their work and where significant control weaknesses are identified, we consider the impact on the scope of our own work.

Approach to controls testing

For controls considered to be 'relevant to the audit', our work involves evaluating the design of these controls and determining whether they have been implemented ("D & I").

We do not expect to place reliance on the operating effectiveness of controls in the current year.

Our assessment of the internal control environment has not been concluded. We will report to the Audit Committee any findings arising from further procedures.

We will consider any major changes to IT systems in year. This forms part of our ongoing risk assessment of IT systems and will involve Deloitte IT specialists as required.

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Council completes the CIPFA Code checklist during drafting of their financial statements.

We would welcome early discussion on the planned format of the financial statements, and whether there is scope for simplifying or streamlining disclosures, as well as the opportunity to review a skeleton set of financial statements and an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management.

Covid-19 pandemic and its impact on our audit

Covid-19 pandemic and its impact on our audit	
Requirements	The Covid-19 pandemic had a significant impact on the 2019/20 audit process, despite impacting relatively late in the year. We would expect there to be further guidance on accounting and disclosure requirements for 2020/21, where the impact has been much more extensive on all organisations. A key element of this will be communicating risks and governance impacts in narrative reporting, consistent with the Financial Reporting Council's guidance to organisations on the importance of communicating the impact of Covid-19 and related uncertainties, including their impact on resilience and going concern assessments. Entity-specific explanations of the current and expected effects of Covid-19 and the Council's plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation.
Actions	While there may be greater clarity compared to prior year, we would expect organisations as part of their reporting to conduct a thorough assessment of the current and potential future effects of the Covid-19 pandemic including: • Consideration of the impact across the Council's operations, including on its income streams, supply chains and cost base, and the consequent impacts on financial position; • The scenarios assumed in making forecasts and on the sensitivities arising should other potential scenarios materialise (including different funding scenarios); and • The effect of events after the reporting date, including the nature of non-adjusting events and an estimate of their financial effect, where possible.

Impact on the Council	Impact on annual report and financial statements	Impact on our audit
We consider the key impacts on the authority such as: • Interruptions to service provision. • Unavailability of personnel. • Reductions in certain income streams such as parking and leisure fees and charges. • Increases in income from central government funding. • The closure of facilities and premises.	We consider the impact of the outbreak on the annual report and financial statements, including: • Principal risk disclosures • Impact on property, plant and equipment • Valuation of commercial or investment properties • Impact on pension fund investment measurement and impairment • Financial sustainability assessment • Events after the reporting period and relevant disclosures • Bad debts provision policy • Narrative reporting • Impairment of non-current assets • Allowance for expected credit losses	**We consider the impact on the audit including:** • **Resource planning** • **Timetable of the audit** • **Impact on our risk assessment** • **Logistics including meetings with entity personnel.**

Covid-19 pandemic and its impact on our audit

Impact on annual report and financial statements	
Impact on property, plant and equipment	The Royal Institute of Chartered Surveyors issued a practice alert, as a result of which valuers identified a material valuation uncertainty at 31 March 2020 for most types of property valuation. This practice alert was withdrawn in September 2020. Valuation reports at March 2020 typically identified a need to consider potential impairments in future periods, and this year's valuations may reflect more significant movements. The Council will need to consider the approach to its valuation (including any changes as a result of the pandemic). The Council will also need to consider whether there are any indications of impairment of assets requiring adjustment at 31 March 2021.
Expected credit losses	The Council will need to consider the level of provision required for expected credit losses under IFRS 9 and whether Covid-19 has had any impact on this.
Accounting for Covid-19 response measures	One of the main elements of the response to Covid-19 which will have specific accounting considerations are the Covid-19 grants that the Council has received. CIPFA have not yet published guidance on accounting for Covid-19 grant income, and specific consideration will need to be given as to whether the Council is acting as the principal or agent in relation to the various grants. The Council has prepared an assessment of Covid-19 grant income and the proposed treatment which we will review in due course.
Narrative and other reporting issues	The following areas will need to be considered by the Council: • Narrative reporting as well as the usual reporting requirements will need to cover the effects of the pandemic on services, operations, performance, strategic direction, resources and financial sustainability. • Reporting judgements and estimation uncertainty, the Council will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities.
Events after the reporting period and relevant disclosures	Events are likely to continue to move swiftly, and the Council will need to consider the events after the Reporting Period and whether these events will be adjusting or non-adjusting and make decisions on a transaction by transaction basis.

Materiality

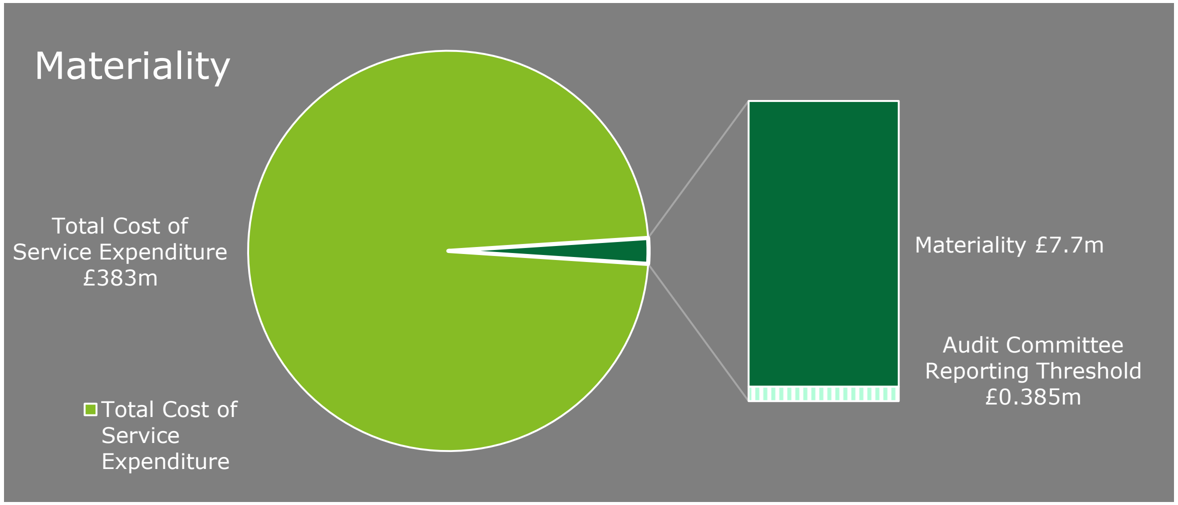
Our approach to materiality

Basis of our materiality benchmark

- The audit partner has determined materiality as £7.7m (£7.6m in 2019/20), based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of total cost of service expenditure based on the 2019/20 accounts as the benchmark for determining materiality.
- We will re-visit the determined materiality based on review of final outturn information when available.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £0.39m (£0.39m in 2019/20).
- We will report to you misstatements below this threshold if we consider them to be material by nature.



Although materiality is the judgement of the audit partner, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Scope of work and approach

Audit considerations regarding the Group Accounts

We have not been appointed the auditor of the material subsidiary trusts and companies within the group. In order to gain sufficient assurance over significant account balances in the group accounts, we will perform further audit procedures at the material components. The relevant components for audit procedures are shown in the table below. These are based on 2019/20 figures. Based on discussion with management, we do not anticipate significant changes for the 2020/21 audit period. This may be revised based on actual 2020/21 outturn.

Components	Expenditure (Cost of Services) 2019/20 £m	Net Assets 31/3/20 £m	%age of total Group Expenditure	%age of group Net Assets	Summary of work to be performed
Council	383.2	505	95%	97.1%	The Deloitte group audit team will perform full-scope audit procedures under the code on this component.
Trust Funds	1.3	23	0.32%	4.42%	The Trust Funds are audited separately by a different firm with a timeline that may not meet audit deadlines. For the purpose of the group audit opinion, material Trust funds will have specified tests performed by the group team focused on assets held.
South Essex Homes Limited	10.5	(3.1)	2.6%	(0.6%)	SEHL is audited separately by a different firm with a timeline that may not meet audit deadlines. For the purpose of the group audit opinion, SEHL will have specified tests performed by the group team.
Southend Care Limited	8.4	(4.6)	2.08%	(0.88%)	SCL is audited separately by a different firm with a timeline that may not meet audit deadlines. For the purpose of the group audit opinion, SCL will have specified tests performed by the group team.

Group Materiality

Materiality for the group is £7.8m in line, but slightly higher than, the Council level alone of £7.7m. In order to apply meaningful specified procedures to the non-Council, in-scope group entities, component materiality will be reduced accordingly based on the percentage of the group represented by each subsidiary and will be no more than 40% of the group materiality figure of £7.8m.

Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you.

We note the planned schedule below has been impacted by Covid 19 with the final deadline set as 30 September 2021. It is still our intention to complete the vast majority of the required audit work in the June/July period.

Pre Planning activities	Planning fieldwork	Year end fieldwork	Finalisation of the audit
• Agreement of overall scope of the audit • Agreement of audit fees and supporting assumptions	• Understand the Council's accounting and business processes • Perform risk assessment procedures for financial statements and VFM • Respond to VFM significant risks • Complete interim audit procedures as agreed with officers	• Year-end audit field work • Update VFM risk assessment • Year-end closing meetings • Reporting of significant findings from the audit	• Reporting of other control deficiencies • Signing audit report • Debrief session with the finance team • Assurance procedures on the Council's WGA return • Annual audit letter
Discussion with management	Planning report to the Audit Committee	Any additional reporting as required	Final report to the Audit Committee and Annual Audit Letter
Jan 2021	Feb – May 2021	June - July 2021	August – Sept 2020

Ongoing communication and feedback

Your control environment
What we consider when we plan the audit

We expect management and those charged with governance to recognise the importance of a strong control environment and take proactive steps to deal with deficiencies identified on a timely basis, particularly where they are subject to the principles of the UK Corporate Governance Code.

Responsibilities of management

Auditing standards require us to only accept or continue with an audit engagement when the preconditions for an audit are present. These preconditions include obtaining the agreement of management and those charged with governance that they acknowledge and understand their responsibilities for, amongst other things, internal control as is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Responsibilities of the audit committee

The Audit Committee is responsible for:

- Reviewing the internal control and risk management systems (unless expressly addressed by separate board risk committee).
- Explaining what actions have been, or are being taken to remedy any significant failings or weaknesses.

As stakeholders tell us that they too wish to understand how external audit challenges and responds to the quality of an entity's control environment, we are seeking to enhance how we plan and report on the results of the audit in response. We will be placing increased focus on how the control environment impacts the audit, from our initial risk assessment, to our testing approach and how we report on misstatements and control deficiencies.

Reliance on controls	We test evaluate the design and test the implementation of key controls for the audit. We have historically not adopted a control reliant approach, on the basis of efficiency.
Performance materiality	We set performance materiality as a percentage of materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality. We determine performance materiality, with reference to factors such as the quality of the control environment and the historical error rate. Where we are unable to rely on controls, we may use a lower level of performance materiality.

Significant risks – statement of accounts

Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the narrative report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality; and
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements.

Deloitte view

IAS 1 requires entities to make disclosures about the assumptions it has made about the future and other major sources of estimation uncertainty at the year end that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year.

If a matter does not meet this criterion, it should not be included in the disclosure on sources of estimation uncertainty.

We recommend the Council re-examine whether the estimates it disclosed in the prior year meet this criterion.

Inherent Red risks

- Council Budget/Financial Sustainability
- Recruit/Retain staff
- External challenges e.g. Brexit, government agenda, relationships with key partners
- Changes in government housing policy
- Access to regeneration funding
- Failure to integrate Heath and Social Care
- Children’s Services Improvement Plan
- Surface flooding and seafront cliff movement
- Cyber Security
- Waste contracts
- Major infrastructure
- Meet Local Plan deadlines

IAS 1 Critical judgements and accounting estimates

- Future levels of funding
- Recognition of schools on the balance sheet
- PPE valuations
- Pension liability valuation

Prior year significant risks

- Valuation of properties
- Management override of controls
- Capital expenditure

Changes in environment

- Upcoming capital projects
- Southend 2050

We have noted above “inherent” risks scored as “Red”. We note the Council Risk Register reflects inherent, current and target risks defined as follows:

Inherent score – the risk scored with no controls, assurances or actions in place.

Current score – the risk scored with controls, assurances and progressed actions.

Target score – the risk score with controls and assurances in place and linked actions completed.

The latest risk register indicated that no risks have a “Current” rating as “Red”.

Significant audit risks

Risk 1 – Property Valuation

Risk identified	The Council held dwellings of £375m and other land and buildings (principally schools) of £266m at 31 March 2020 which are required to be recorded at current or fair value at the balance sheet date. The authority also holds £41m of commercial investment property. The fixed asset portfolio is divided into five key asset categories. The Council's practice is to obtain a specific valuation on one of the five asset categories at the start of the year on a cyclical basis. This approach leads to the full asset portfolio being evaluated within each five-year period. In addition to this specific exercise the Council also obtains advice as to whether there has been a material change in the period up to the balance sheet date based on indices. Any changes based on index factors are then applied to the total asset base. Key judgements include: • Whether there has been a material change since the date of the last valuation. • In the valuation of dwellings, defining appropriate beacon groups, such that the level of homogeneity of properties within each group is appropriate, and selecting appropriate comparators and, where relevant, making appropriate adjustments. The dwellings population are in scope for full revaluation for 2020/21.
Our response	We will test the design and implementation of key controls in place around the property valuation. We will use our valuation specialists, Deloitte Real Estate, to review the methodology and approach and to challenge the appropriateness of the year-end valuation, focusing on the key subjective inputs. This will support confirmation that the valuation movements are consistent with expectations seen in other data regarding the property market. Our specialists will also evaluate the methodology applied in and the outcomes of the full valuation of the Council Dwellings category, performed as at 1 April 2020 and will assess and challenge the index-based factor applied to the whole property portfolio to adjust the overall valuation to the balance sheet date.

Significant audit risks

Risk 2 – Capital Expenditure

Risk identified	As part of the Medium Term Financial Strategy, the Council has a substantial capital programme of £233m over the next five years. The capital programme included £59.7m spend in 2019/20. Determining whether or not expenditure should be capitalised can involve judgement as to whether costs should be capitalised under International Financial Reporting Standards. The Council has greater flexibility of the use of revenue resource compared to capital resource. There is also, therefore, an incentive for officers to misclassify revenue expenditure as capital. We have therefore identified classification of capital expenditure as a fraud risk in the financial statements.
Our response	We will test the design and implementation of controls around the capitalisation of costs. We will select a sample of additions in the year to test whether they have been appropriately capitalised in accordance with the accounting requirements. This sample will include Assets Under Construction.

Significant risks
Risk 3 – Management override of controls

Risk identified	In accordance with ISA 240 (UK and Ireland) management override of controls is a presumed significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Authority's controls for specific transactions. The key judgments in the financial statements are those which we have selected to be the significant audit risks; capitalisation of expenditure and valuation of the Authority's estate. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.
Our response	In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk: • We will risk assess journals and select items for detailed follow up testing. We do this by using computer-assisted profiling to identify journals which have characteristics of increased interest. We will then test the appropriateness of journal entries selected through this profiling activity, and other adjustments made in the preparation of financial reporting. • We will review accounting estimates for evidence of bias that could, in aggregate, result in material misstatements due to fraud. Other areas of estimation in addition to the above include provisions (of which the most significant is the provision for NNDR appeals), bad debt provisions and estimation of depreciation based on a selection of useful economic lives. • We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

Value for money

There is a new Code of Audit Practice for 2020/21 onwards. The Code is applicable to NHS Trusts and Foundation Trusts, CCGs, and Local Authorities. This introduces significant changes to the requirements around Value for Money (the arrangements to secure economy, efficiency, and effectiveness in the use of resources). The NAO issued Auditor Guidance Note 03 (AGN03), Value for Money, in October 2020 setting out more detailed guidance on how the new requirements should be implemented. Key features of the requirements include:

For all bodies, the auditor will need to provide a public narrative commentary against the Value for Money criteria in a new "Auditor's Annual Report" (AAR), to be issued alongside the audit opinion for Local Authorities. This commentary will include a summary against each of the reporting criteria, setting out the work undertaken, and judgements and local context relevant to the findings. This commentary needs to be supported by more extensive work to understand the body's arrangements to secure economy, efficiency and effectiveness, to support this commentary and to identify whether there are risks of significant weaknesses in arrangements.

If a risk of significant weaknesses is identified, additional work is required to determine whether there are significant weaknesses and to make relevant recommendations if this is the case on a timely basis, which will also be explained in the Auditor's Annual Report. The AAR will also include follow up on previous recommendations in respect of significant weaknesses and whether they've been implemented satisfactorily. The audit opinion will continue to include reporting by exception, though now this will be where the auditor has identified a significant weakness in arrangements rather than an overall conclusion on arrangements. The three criteria that would be considered in Value for Money work are be:

> Financial sustainability: How the body plans and manages its resources to ensure it can continue to deliver its services;
>
> Governance: How the body ensures that it makes informed decisions and properly manages its risks; and
>
> Improving economy, efficiency and effectiveness: How the body uses information about its costs and performance to improve the way it manages and delivers its services.

The National Audit Office and the audit firms are continuing to discuss the practical implementation of these new requirements and expectations as to the extent of procedures underpinning these requirements. Expectations in this area are likely to continue to evolve as practical issues emerge in implementation.

We will:

- Undertake VfM planning work under the revised procedures.
- As the detailed impact on scope becomes clearer, we will discuss and agree the impact of the required scope changes with management.
- Our year-end reporting will include our draft findings ahead of issue of the Auditor's Annual Report.

Reporting hot topics

Increased focus on quality reporting

Deloitte view

The expectations of corporate reporting, reflected in the FRC's monitoring and enforcement priorities, are increasing. While the focus is primarily on corporates, we highlight these areas where improved disclosures would help meet stakeholder expectations.

The potential impacts of Brexit

Depending upon events, organisations may be preparing annual reports against the backdrop of continued uncertainty around the UK's future relationship with the EU. Even with a deal, the future basis of UK-EU trade will affect the longer-term viability period of 3-5 years and a longer consideration of prospects.

ACTION: Depending upon events, we would expect to see annual reports reflecting at least:

- relevant risks and uncertainties, and actions taken to manage those risks; and
- consideration whether any impact on critical accounting judgements and areas of estimation uncertainty.

We will discuss with the Council closer to the time areas where disclosures may be appropriate.

Climate-related risks

The report by the Intergovernmental Panel on Climate Change (IPCC) has made it clear that prompt and decisive action on climate change is required from governments, businesses and individuals alike.

The recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD) are gaining momentum. The government has proposed mandatory TCFD disclosures by 2022, and the FRC is undertaking a major review of how organisations assess and report the impact of climate change. The FRC expects organisations to disclose how they have taken climate change into account in assessing the resilience of the business model, its risks, uncertainties and viability both in immediate and longer term.

Investors are challenging companies that are not factoring the effects of the Paris Climate Agreement into their critical accounting judgements and are not disclosing comprehensively these judgements, assumptions, sensitivities and uncertainties.

ACTION: In line with best practice, we recommend the Council clearly articulate how your organisation is addressing climate change e.g.

- whether this is a principal risk and how it is being managed; and
- its impact on the business model, the viability statement and the key assumptions and projections in impairment reviews and valuations (including in assessing remaining asset lives).

Revisions to auditing standards coming into effect

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Since 2015, the International Auditing and Assurance Standards Board (IAASB) has sought to identify audit issues relating to accounting estimates for financial institutions and other entities. Initially, this focused on the impact of IFRS 9 *Financial Instruments*, because it would fundamentally change the way that banks and other entities account for loan assets and other credit exposures.

However, the IAASB concluded that most, if not all, issues identified for expected credit losses would be equally relevant when auditing other complex accounting estimates. Accordingly, a holistic revision of ISA 540 was undertaken and the new standard takes effect for periods commencing on or after 1 January 2020. For NHS bodies, this will be March 2021 year ends and later.

We summarise on the next few slides how this will impact our audit.

> *"There is a clear need to update ISA 540 to support better quality audits of increasingly complex accounting estimates"*
>
> FRC letter to the IAASB, July 2017

Area of change	Impact on our audit	Impact on the officers
Assessment of oversight and governance relating to estimates	In connection with our planning work to understand the entity and its environment, including internal control, we will specifically inquire regarding management's processes, and the oversight and governance of those processes relating to accounting estimates. Key areas of estimation include revenue recognition, property valuations, accruals and any material year end provisions.	You will need to consider the adequacy of your processes and controls over estimates, and documentation thereof.

Revisions to auditing standards coming into effect

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Area of change	Impact on our audit	Impact on the officers
Identification of inherent risk factors; separate assessment of inherent risk and control risk. Objectives-based work effort requirements.	Recognising a spectrum of inherent risk, we will assess risks of material misstatement in estimates with reference not only to estimation uncertainty, but also complexity, subjectivity or other inherent risk factors, and the interrelationship among them. We will specifically assess control risk relating to estimates, which may require us to evaluate the design and determine implementation of an increased number of internal controls. Our subsequent audit procedures will be responsive to this assessment, and designed to obtain evidence around the methods, significant assumptions, data and (where applicable) the selection of a point estimate and related disclosures about estimation uncertainty.	You will need to provide clear documented rationale for (a) the selection and application of the method, assumptions and data in making the accounting estimate, including any changes in the current year, and controls relating to those aspects; and/or (b) the selection of a point estimate and related disclosures for inclusion in the financial statements.
Enhanced “stand back” requirement, to evaluate the audit evidence obtained.	We will specifically design our procedures, to enhance our application of professional scepticism, so that they are not biased towards finding corroborative evidence; our overall evaluation of the evidence obtained will weigh both corroborative and contradictory evidence.	You should expect more challenge of the evidence provided in support of accounting estimates, use of external data sources and your consideration of contradictory evidence.

Revisions to auditing standards coming into effect

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Area of change	Impact on our audit	Impact on the officers
Enhanced requirements about whether disclosures are "reasonable" .	The extant ISA 540 required us to evaluate whether disclosures were "adequate". The change to "reasonable" will involve greater consideration of the overall meaning conveyed through disclosures. For example, where estimation uncertainty associated with an estimate is multiple times materiality, we will consider whether the disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes.	You should expect more challenge on disclosures relating to estimates, particularly for where you have selected a point estimate from a range and those with high estimation uncertainty.
New requirements when communicating with those charged with governance.	In accordance with ISA (UK) 260 and ISA (UK) 265, our communications from the audit have included significant qualitative aspects of your accounting practices and significant deficiencies in internal control. With the revised ISA (UK) 540, these communications will specifically include matters regarding accounting estimates and take into account whether the reasons for our risk assessment relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors.	You should expect increased reporting in relation to accounting estimates which may be mirrored in our audit report if it involves a Key Audit Matter.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes our audit plan, including key audit judgements and the planned scope.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by officers or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the statement of accounts and the other procedures performed in fulfilling our audit plan.

Use of this report

This report has been prepared for the Audit Committee, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.

Other relevant communications

We will update you if there are any significant changes to the audit plan.

Deloitte LLP

Deloitte LLP

St Albans | 19 April 2021

Appendix 1 - Fraud responsibilities and representations

Responsibilities explained

Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with officers and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our Responsibilities:

- We are required to obtain representations from your officers regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the statement of accounts as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of valuation of land and buildings, capital expenditure and management override of controls as key audit risks for your organisation.

Fraud Characteristics:

- Misstatements in the statement of accounts can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the statement of accounts is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the statement of accounts may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:
  - (i) officers;
  - (ii) officers who have significant roles in internal control; or
  - (iii) others where the fraud could have a material effect on the statement of accounts.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's statement of accounts communicated by officers, former officers, analysts, regulators or others.

Appendix 1 - Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:

Officers:

- Officers assessment of the risk that the statement of accounts may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Officers process for identifying and responding to the risks of fraud in the entity.
- Officers communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Officers communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether officers have knowledge of any actual, suspected or alleged fraud affecting the entity.
- We plan to involve officers from outside the finance function in our inquiries.

Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

Those charged with governance

- How those charged with governance exercise oversight of officers processes for identifying and responding to the risks of fraud in the entity and the internal control that officers have established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

Appendix 2 - Independence and fees

Independence

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2021 in our final report to the Audit Committee.
Non-audit fees	There are no non-audit fees. In relation to the 2019/20 reporting period but during 2020/21 we provided Housing Benefit Assurance (£21k) and Teachers Pensions Assurance (£6k). This work is routine attest work that is regularly provided by the external auditor.
Independence monitoring	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We have no other relationships with the Authority, its members, officers and affiliates, and have not supplied any services to other known connected parties.

Appendix 2 - Fees

The professional fees expected to be charged by Deloitte in the period from 1 April 2020 to 31 March 2021 and as set out in our fee letter issued 9 October 2020 are as follows:

	Current year £'000
Financial statement audit including Whole of Government and procedures in respect of Value for Money assessment	159
Total audit	159
Audit related assurance services	-
Other assurance services	6
Total assurance services	6
Total fees	165

We note that the fee above represents an increase to the scale fee for the audit. The scale fee is £109k. The revision to the fee was communicated to management in October 2020 and will still need to be agreed with PSAA.

Appendix 3 - Our approach to quality

AQR team report and findings

Audit quality remains our number one priority and we have a relentless commitment to it. We continue to invest in and enhance our Audit Quality Monitoring and Measuring programme.

In July 2020 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2019/20 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality.

We are pleased with our results for the inspections of FTSE 350 entities achieving 90% assessed as good or needing limited improvement, which included some of our highest risk audits. Our objective is for 100% of our audits to be assessed as good or needing limited improvement and we know we still have work to do in order to meet this standard. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm wide actions.

We are also pleased to see the impact of our previous actions on prior year adjustments is reflected in the results of current year inspections with no findings in this areas. In addition the FRC identified good practice examples including in: risk assessment, group oversight, our comprehensive IFRS9 expected credit loss audit programme and our audit committee reporting.

Embedding a culture of challenge in our audit practice underpins the key pillars of our audit strategy. We invest continually in our firm wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website.
https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports