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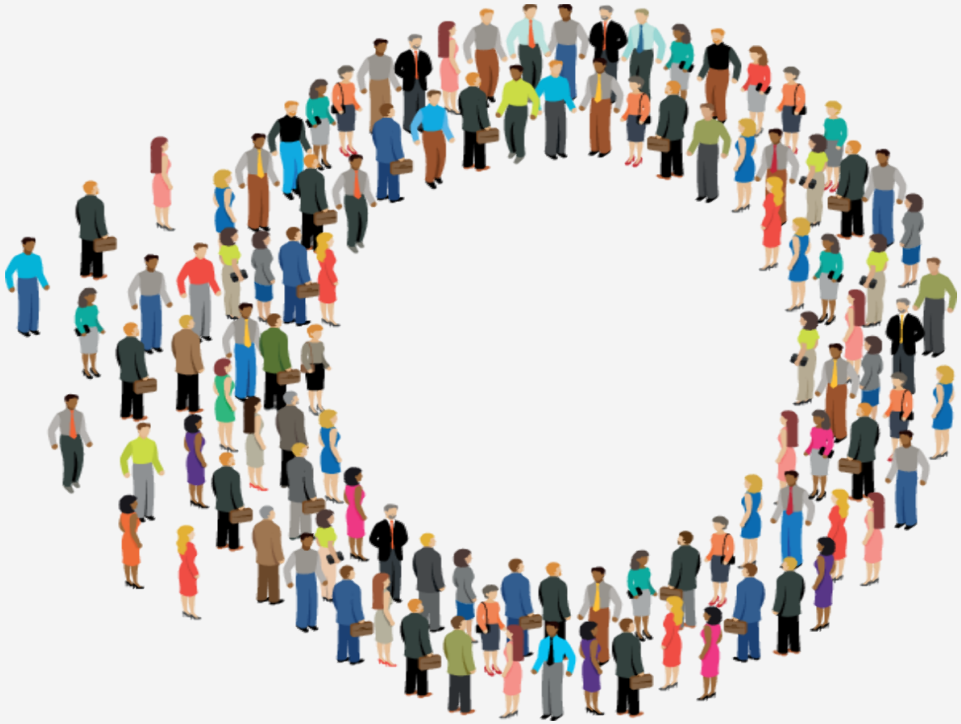
TOWER HAMLETS



London Borough of Tower Hamlets

Audit planning report to the Audit Committee for the year ending 31 March 2019

Issued 2 April 2019 for the meeting on 11 April 2019

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Introduction

The key messages in this report:

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.

We have pleasure in presenting our planning report to the Audit Committee for the 2019 audit. We would like to draw your attention to the key messages of this paper:

Scope of our work	Our audit work will 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. There have not been any changes to the Code, itself, and therefore the scope of our work is broadly similar to the scope of work set for your auditor in the prior year. We have prepared a separate audit planning report covering our work on the pension scheme. 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	We summarise below the areas of significant audit risk we have so far identified: • Valuation of properties – there is significant judgement over subjective inputs to the valuation. • Capitalisation of expenditure – there is judgement over the appropriate classification of spend as capital and not revenue. The Council has greater flexibility over the use of its revenue compared to its capital resources. 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.

Introduction

The key messages in this report:

Areas of focus in our work on VFM	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 predecessor qualified his report in relation to outstanding actions in the Council's Best Value Implementation Plans and Ofsted findings in their April 2017 report on children's services which provided evidence that the Council did not have proper arrangements in place in relation to "informed decision making" and "working with partners and other third parties". We regard these qualification issues to be significant risks and will undertake work to conclude whether or not the matters giving rise to the previous year's qualified conclusion are also relevant to the current year. Our risk assessment to determine whether there are any further significant risks is at a very early stage. We expect to carry out the majority of our risk assessment procedures in the remainder of March and early April. 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 and the outcome of any findings from the work of regulators.
Brexit	The arrangements following the UK's exit from the EU are not yet clear. Our audit plan does not include any risks or procedures in respect of the impact upon the Authority, whether on Value-for-Money (VfM) arrangements, or more widely. We will update the Audit Committee if any risks are identified as the eventual circumstances of the UK's exit become clear.

Our audit of the statement of accounts explained

We tailor our audit to your Authority

Identify changes in your business and environment

Directions issued by the Secretary of State in relation to Best Value implementation were lifted. The Council commenced preliminary works on its new Town Hall and repaid its LOBO loan early.

2018/19 will also be the first financial period that the Council will adopt both International Financial Reporting Standard 15 – Revenue and International Financial Reporting Standard 9 – Financial Instruments.

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 materiality to be £25m, representing 2% of estimated gross spend on services.

Materiality applied by our predecessor in the prior year was £17.5m.

We will report any uncorrected misstatement misstatements in excess of £1.25m to the audit committee.

Significant risk assessment

We have identified the appropriate capitalisation of expenditure as a new area of significant risk.

Our predecessor identified grant payments and related party reporting and estimation of the pension liability as significant risks. We have concluded that these no longer represent significant audit risks.

We discuss these changes further on page 10.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of the London Borough of Tower Hamlets. 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 of Audit Practice

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").

We also issue a separate opinion that relates to the accounts of the pension fund.

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.

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 provide a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We carry out a risk assessment to identify any risks that, in our judgement, have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. The risk assessment enables us to determine the nature and extent of further work that may be required. This means that if we do not identify any significant risks, there is no requirement to carry out further work.

We also consider the impact of findings of other inspectorates, review agencies and other relevant bodies on their risk assessment, where they are relevant and available.

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 have met with Internal Audit to discuss their work. We have reviewed reports issued in the period to 31 December 2018 and will update this for further reports issued as part of the 2018/19 internal audit programme. We consider the findings from their work as part of our risk assessment and where significant control weaknesses are identified, we consider the impact on the scope of our own work. We do not propose to place direct reliance on the work of internal audit.

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.

Materiality

The audit partner has determined materiality as £25m, 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 gross spend on services, adjusted to remove the effect of impairments and reversals of impairments against properties, as the benchmark for determining materiality as this is an area of focus for users of the accounts.

We will report any uncorrected misstatement misstatements in excess of £1.25m to the audit committee.

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.

Transition activities	Planning fieldwork	Year end fieldwork	Other reporting	Post reporting activities
• Introductory meetings with senior officers • Meeting with predecessor auditor and review of their prior year files • 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	• Year-end audit field work • Update VFM risk assessment • Year-end closing meetings • Reporting of significant findings from the audit • Signing audit report	• Assurance procedures on the Council's WGA return • Signing audit report on the separate pension scheme annual report • Annual audit letter	• Debrief session with the finance team • Reporting of other control deficiencies • Signing of audit reports in respect of subsidiary undertakings (where appointed)
Annual fee letter	Planning report to the Audit Committee	Final report to the Audit Committee	Annual audit letter	Any additional reporting as required
April 2018 – Jan 2019	Jan – April 2019	June - July 2019	July – August 2019	August – Sept 2019

Ongoing communication and feedback

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.

In preparing the 2018/19 statement of accounts, we recommend the Council re-look at whether the estimates it disclosed in the prior year meet this criterion.

Red or amber risks (Q3)

- Death or serious harm to child or vulnerable adult
- Implementation of external recommendations
- Failure to extend Mulberry Place lease or find alternative space.

Changes in your business and environment

- Preliminary works commence on new Town Hall
- LOBO loans redeemed

IAS 1 Critical accounting estimates

- Useful economic lives of property, plant and equipment
- Heritage asset valuation
- NNDR appeals provision
- Pension liability valuation

Prior year significant audit risks (financial statements)

- Valuation of properties
- Management override of controls
- Grant payments
- Conflicts of interest

The Code of Practice on Local Government Accounting requires the statement of accounts to include a narrative report which provides information on the authority, its main objectives and strategies and the principal risks that it faces. The Council's prior year narrative report provides only a limited commentary identifying the principal financial risks, but does not provide a commentary on non financial risks or the Council's risk mitigation strategy. As a whole, the narrative report in the prior year accounts is very short (5 pages, compared to an average for London Boroughs of 10.5 pages). We recommend the Council reviews how well its current reporting meets the overall objectives of the Code on narrative reporting, as well as the detailed recommendations on content contained in the Code.

Significant risks – statement of accounts

Our risk assessment process

Changes to prior year in risks identified as significant audit risks

The risks we have identified as significant audit risks are summarised on the following pages. They reflect the following changes to the equivalent summary of risks identified by our predecessor for their audit of the 2017/18 accounts:

- We have identified an additional risk in relation to the appropriate capitalisation of expenditure as the capital plan in the current year is substantial.
- In the prior year, our predecessor identified significant audit risks in relation to grants to voluntary bodies and the completeness of related party disclosure information. In view of the progress made by the Council leading to the return of functions relevant to these areas, and the absence of past audit findings, we have concluded that these are no longer significant risks.
- Our predecessor also identified a significant risk in relation to the valuation of the pension liability. The process of estimating the quantum of the pension liabilities is usually complex and small changes in assumptions can have a significant impact on the estimated liability. However, the Council has engaged a reputable actuary and we understand that there are no significant changes in the membership of the scheme or significant transactions in the pension scheme which impact on the valuation. For these reasons our preliminary assessment is that the risk of material misstatement is towards the higher end of the range, but is not a significant audit risk. We will update our assessment when we have received and evaluated further information on the actuary's approach and assumptions.

Of particular interest this year will be the impact on the valuation of the recent ruling that all schemes must equalise Guaranteed Minimum Pensions ('GMP') between males and females. Although there have been interim measures to bring about equalisation, it is unclear how this will be factored in by actuaries in calculating the IAS 19 liability. The impact for individual pension schemes will vary; at the current time it is estimated that, in nearly all cases, the potential impact of the ruling will be between 0-2% of the defined benefit obligations of a scheme.

Presumed risk of fraud in revenue recognition

Auditing standards also presume there is a risk of fraud in revenue recognition. Following an analysis of the Council's income streams, we have rebutted 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 by our predecessor last year.

Comments on other higher risks – existence and ownership of properties

Officers have brought to our attention an error they have identified in the prior year statement of accounts. During 2017/18, five grant maintained schools converted to academy status. On conversion, the Council entered into 125 year leases at peppercorn rent. The Council did not capture four of these transactions in preparing the 2017/18 accounts. As a result, non current assets were incorrectly accounted for on the balance sheet at 31 March 2018 on a freehold basis, without taking into account the leasehold interest which the Council had granted to the academy trusts.

Significant risks – statement of accounts

Our risk assessment process

Officers have concluded that the buildings should be classified as finance leases and as a result, a disposal of the full value of the buildings should have been recorded in the 2017/18 accounts. There is more judgement over the treatment of the lease of land, but we have concluded that the land is held under operating leases. As a consequence, an impairment should have been recorded in 2017/18 to reduce the value of the land to reflect the grant of the lease for only peppercorn rent.

Officers advise that the Property, Plant and Equipment balance was overstated by approximately £76m as a result of this error. The Code requires material prior period errors to be corrected by restating the comparative information in the current year statement of accounts. We will examine the calculation of the error and the proposed accounting entries and disclosures once prepared.

Officers have explained the process that has been implemented to prevent similar errors in the current year.

We would typically view the risk that properties do not exist or that their recognition or carrying amount do not reflect the Council legal interest as towards the lower end of the range. As a result of the issue which has arisen (and notwithstanding the action which officers have taken to prevent similar errors going forwards) and because of the more limited assurance we have in this first year over the opening balance sheet, we have classified this risk as at the higher end of the range, but not a significant audit risk.

Significant risks – statement of accounts

Risk 1 – Property valuation

Risk identified	The Council held dwellings of £1.2bn and other land and buildings (principally schools) of £1.1bn at 31 March 2018 which are required to be recorded at current or fair value at the balance sheet date. The Council's practice is to obtain a valuation at the start of the year (with a full valuation performed for different asset groups on a cyclical basis) and advice as to whether there has been a material change in the period up to the balance sheet date. 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 homogeneity of properties within each group is appropriate, and selecting appropriate comparators and, where relevant, making appropriate adjustments • In the valuation of schools, appropriate selection of the location and design of modern equivalents.
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 judgements made on the timing and type of valuation performed and whether this is adequate for the valuation as a whole to remain current at year end. We will also use our valuation specialists to assist in reviewing the qualifications and experience of the valuer and their methodology and approach and to challenge the appropriateness of the year-end valuation, focusing on the key subjective inputs. Other work on the valuation, which does not form part of the significant risk, includes tests on information provided to the valuer for the purpose of the valuation, including pupil numbers and location and type of residential stock, tests on the posting of the revalued amounts to the financial statements and recalculation of gains and losses and posting to the appropriate accounts in the financial statements.

Significant risks – statement of accounts

Risk 2 – Capital expenditure

Risk identified	The Council has a substantial capital programme of £0.6bn over the next three years, including £166m (revised estimate) in 2018/19. 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 over the use of revenue resource compared to capital resource. There is also, therefore an incentive for officers to misclassify revenue expenditure as capital.
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.

Significant risks – statement of accounts

Risk 3 – Management override of controls

Risk identified	In accordance with ISA 240, 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 conclusion

Our risk assessment process

We are required to provide a conclusion on whether the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

The Code and supporting auditor guidance note require us to perform a risk assessment to identify any risks that have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. We are required to carry out further work where we identify a significant risk - if we do not identify any significant risks, there is no requirement to carry out further work.

Our risk assessment procedures include:

- Reading the annual governance statement
- Considering local and sector developments and how they impact on the Council
- Reviewing the audit report issued by our predecessor in respect of 2017/18
- Meeting with senior officers
- Reviewing reports issued by internal audit
- Reviewing other documentation of the Council including budget setting reports, financial and operational performance monitoring reports
- Understanding the arrangements in potential areas of significant risk – in particular the planning of the Council's finances
- Reviewing reports issued by regulators.

Our risk assessment to determine whether there are any further significant risks is at a very early stage. We expect to carry out the majority of our risk assessment procedures in the remainder of March and early April and therefore expect to be in a position to provide an oral update to the meeting.

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 and the outcome of any findings from the work of regulators.

Our predecessor qualified his report in relation to outstanding actions in the Council's Best Value Implementation Plans and Ofsted findings in their April 2017 report on children's services which provided evidence that the Council did not have proper arrangements in place in relation to "informed decision making" and "working with partners and other third parties".

We regard these qualification issues to be significant risks and will undertake work to conclude whether or not the matters giving rise to the previous year's qualified conclusion are also relevant to the current year.

We have set out further information on these risks and our planned response on the next page.

Value for money conclusion

Significant risks

Risk identified	In their inspection report published 7 April 2017, Ofsted rated children's services in Tower Hamlets as "inadequate". This overall assessment incorporated inadequate ratings for the following assessment categories: children who need help and protection; and leadership, management and governance. Our predecessor concluded that these circumstances provided evidence of weaknesses in proper arrangements. There is a risk that the matters giving rise to the previous year's qualified conclusion are also relevant to the current year.
Our response	We will read the original inspection report and reports from subsequent monitoring visits and discuss with the Corporate Director responsible for children's services. However, we currently expect that our 2018/19 report will be qualified in respect of this matter: • We would ordinarily consider that significant regulator concerns over a key service would provide evidence of governance and control weaknesses. • The service has not yet been re-inspected and the current rating remains inadequate. • Our conclusion is given in respect of arrangements throughout the year and not just at the year end.

Risk identified	During 2017/18, the Council were subject to Directions issued by the Secretary of State which required the Council to set up a Best Value Improvement Board; submit quarterly progress reports on the Best Value Improvement Plan to the Secretary of State; and set up an independent review of the achievement of the Best Value Improvement Plan with a report to the 1 August 2018. Our predecessor noted that not all actions were confirmed as completed or on track and anticipated that the impact of the work would not yet be embedded and concluded that these circumstances provided evidence of weaknesses in proper arrangements. There is a risk that the matters giving rise to the previous year's qualified conclusion are also relevant to the current year.
Our response	During 2018/19, the Council completed the actions specified in Directions. On the basis of the peer challenge review submitted to the Secretary of State, the Directions were lifted. Our conclusion is given in respect of arrangements throughout the year and not just at the year end. We will review the peer challenge review report and consider the scope and findings. We will also consider the significance of issues open at the start of the year and the timeline for their closure during the year.

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. It also includes an update on developments in financial reporting which may impact on the Council in the current or future years.

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.

Other relevant communications

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

Deloitte LLP

St Albans | 2 April 2019

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 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 2019 in our final report to the Audit Committee.
Non-audit fees	We were appointed to carry out the audit of an unconsolidated subsidiary of the Council (further information is included on the next page). We are in discussion over carrying out agreed on procedures on the Council's benefit subsidy claim. There are no other non-audit fees.
Independence monitoring	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 2018 to 31 March 2019 are as follows:

	Current year £'000
Audit under the NAO's Code of Audit Practice: Council	161
Audit under the NAO's Code of Audit Practice: Pension fund	16
Total fees under the NAO's Code of Audit Practice	**177**

In addition, we have received a fee of £5,000 for the audit of the statutory accounts of Seahorse Homes Limited, an unconsolidated subsidiary of the Council, for the period ended 31 March 2018.

We are in discussion over carrying out agreed on procedures on the Council's benefit subsidy claim.

Appendix 3 – Developments in financial reporting

We have set out below developments which may impact on the 2018/19 statement of accounts, together with a key change to the accounting for leases which has been deferred to 2020/21:

New accounting standards in 2018-19 - IFRS 9 Financial Instruments	IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 reclassifies financial assets and aims to simplify financial instrument accounting by more closely aligning accounting with how instruments are used in the business. The accounting code sets out several transitional issues and arrangements for authorities reporting under IFRS 9. The most significant change for local authorities will be the change in the impairment loss model for financial assets from one based on incurred losses to one based on expected (credit) losses. Under IFRS 9 the other significant change is that assets currently classified as available for sale will potentially be reclassified to fair value through profit and loss.	This change to accounting standards may have implications for the Council and officers will, in particular, need to re-visit its process for determining impairment losses as well as meeting new disclosure requirements.
New accounting standards in 2018-19 - IFRS 15 Revenue from Contracts with Customers	IFRS 15 Revenue from Contracts with Customers introduces a step-by-step process for identifying contractual performance obligations, allocating the transaction price to those obligations, and recognising revenue only when those obligations are satisfied.	IFRS 15 is not generally expected to have a substantial effect for local authorities, but the Council will need to be able to demonstrate how it has thought through the financial reporting implications and how it will meet the substantial disclosure requirements, including implementing any new data collection processes.

Appendix 3 – Developments in financial reporting

Guaranteed Minimum Pensions Equalisation	In the recent Lloyds Bank High Court case, the judge has ruled that all schemes must equalise Guaranteed Minimum Pensions ('GMP') between males and females. This case has provided clarity in an area where previously there has been uncertainty in pensions law. In the public sector the government have held two consultations in recent years which have led to interim measures to equalise. Although there have been interim measures to bring about equalisation it is unclear how this has been factored in by actuaries in calculation of the IAS 19 liability.	At the current time it is estimated that, in nearly all cases, the potential impact of the ruling will be between 0-2% of the defined benefit obligations of a scheme. In forming our view on this input to the pension liability estimate, we will both use our own actuarial specialist and have regard to the finding of a review commissioned by the NAO looking at the approach taken by the principal actuarial firms involved with LGPSs.
Changes to the 2018-19 accounting code	CIPFA/LASAAC has made several changes to the 2018-19 accounting code: • Confirmation that the service analysis section of the Comprehensive Income and Expenditure Statement (CIES) no longer provides the IFRS 8 Operating Segments reporting requirements, though the service analysis will be consistent with the Expenditure and Funding Analysis note. The Expenditure and Funding Analysis will provide the segmental reporting requirements. • Several clarifications to improve the segmental reporting requirements of the Code, including a commentary that extra columns can be added to the Expenditure and Funding Analysis if this was needed to ensure that local authorities clearly demonstrate the relationship of their segmental analysis, the General Fund and the service analysis presented in the CIES.	The Council will need to ensure that its accounts template is updated, where relevant, for these changes.

Appendix 3 – Developments in financial reporting

Streamlining the Accounts: Guidance for Local Authorities	CIPFA has published guidance to local authorities to support steps to streamline both the format of their published financial statements and the year-end processes that underpin them. The publication covers streamlining the presentation of local authority financial statements by ensuring that local authorities have identified readers' information needs and convey key messages clearly, concisely and efficiently). This involves: • Using materiality to avoid key messages of the financial statements being obscured by excessive detail; • Reviewing accounting policies so that only important and relevant information is included; and • Considering presentation and layout, to help readers focus on key messages and navigate through the statements It then looks at streamlining the accounts closure process to embed a "right first time" culture which focuses on key transactions and balances and avoids unnecessary work and sets out the characteristics of working papers which support an effective closure and audit process.	We encourage the Council to review its accounts template and year end processes against the good practice points in the guidance and make changes as relevant.

Appendix 3 – Developments in financial reporting

Deferral of IFRS 16 Leases to 2020/21	The new leasing standard IFRS 16 Leases will replace IAS 17. Implementation has been deferred to the 2020-21 financial year. The new standard eliminates the distinction between operating and finance leases for lessees and brings in a single approach under which all but low- value or short term (less than 12 months) leases are recognised. The distinction between operating and finance leases for lessors is maintained. The Council will need to: • have arrangements for capturing information on leases and contracts; and • recalculate lease liabilities for arrangements that have variable elements such as index-linked increases (which is likely to include most PFI contracts).	Successful implementation of the new standard will depend on the Council collating and reviewing relevant information about their new and existing leases. This will require a significant exercise to collect and analyse relevant information and the Council will need to have an effective project plan and timetable to prepare for implementation on a timely basis.

Appendix 3 – Developments in financial reporting

Revising the Minimum Revenue Provision	Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (2003 Regulations), as amended, requires local authorities to set aside a prudent amount of Minimum Revenue Provision (MRP). MHCLG has issued updated Minimum Revenue Provision Guidance, which applies from 1 April 2019 with the exception of paragraphs 27-29 "Changing methods for calculating MRP", which apply for accounting periods starting on or after 1 April 2018. Early adoption of the guidance is encouraged but is not required. The new guidance: • Clarifies that, except in cases where an authority has negative or nil Capital Financing Requirement or is offsetting a previous deliberate overpayment of MRP, MRP should never be nil or a negative charge; • Sets maximum economic life for assets in assessing MRP; and • Offers some flexibility for PFI assets. There is also some flexibility where the authority has the view from a professionally qualified advisor that an operational asset will deliver benefits for more than the maximum economic life set out in the guidance.	We understand the Council does not intend to early adopt the new guidance
Capital receipts flexibility	In December 2017, MHCLG issued updated guidance on the use of Capital Receipt Flexibilities and confirmed that the programme would remain in place for the next three years. Local authorities can use capital receipts arising from the disposal of assets to flexibly fund revenue costs of service transformational projects. There is a requirement to have a plan for approval by Council of the projects to be funded, and in subsequent years to set out whether that plan has been met.	We understand the Council does not intend to make use of this flexibility in the current or prior year.

Deloitte.