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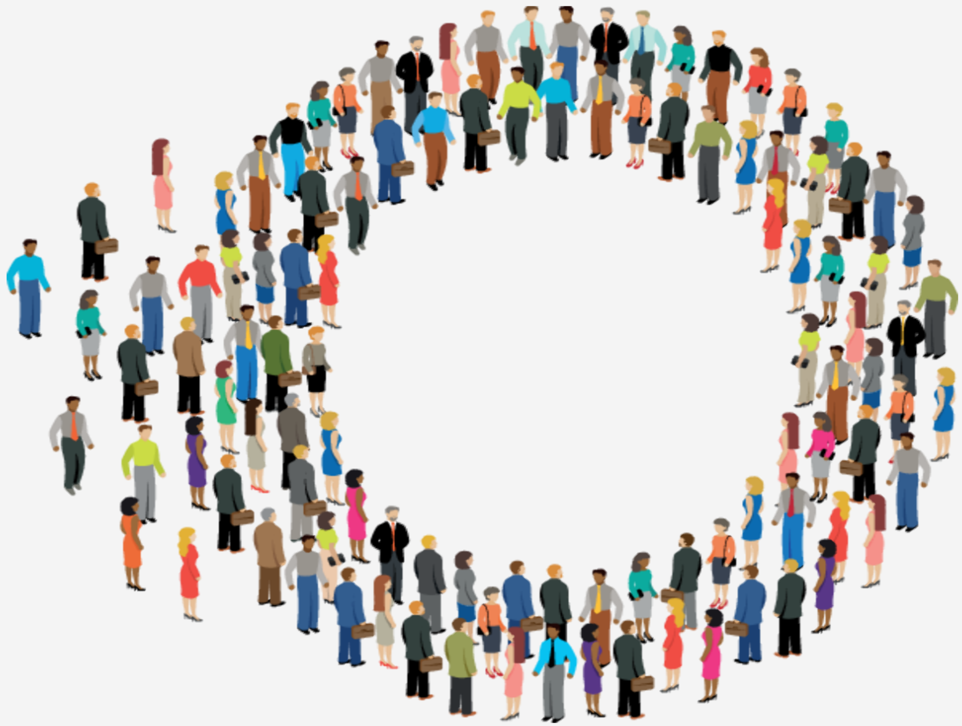

London Borough of Tower Hamlets

Audit planning report to the Audit Committee for the year ending 31 March 2020

Issued 6 May 2020 for the meeting on 13 May 2020

Deloitte confidential: government and public services - for approved external use only

Contents

1 Preliminary planning report

2 Appendices

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 overall objectives of the audit remain the same as last year. We will present a separate audit planning report covering our work on the pension scheme to a later meeting of the Pensions Committee. We have included an overview in this report. 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.
Status of our 2019/20 planning work	Our planning for the 2019/20 is in progress and in particular our risk assessment procedures are not yet complete. This is principally because: (a) Our audit of the 2018/19 accounts is not yet complete and we expect that issues so far identified will impact on both the scope of our 2019/20 audit and the identification and evaluation of risks of material misstatement in the 2019/20 accounts. We do not yet have a complete understanding of some of these issues or the steps management have taken in response. (b) Some information to complete our risk assessment is not available until year end. (c) In this report, whilst we have made reference to the impact of Covid-19, for example in relation to additional uncertainties over the valuation of Property, Plant and Equipment at year end, we have not yet worked through with officers the full range of impacts. As a result, any views expressed in this report are provisional and subject to change once all planning and risk assessment activities is complete.

Introduction
The key messages in this report

Timetable for the audit	We understand that officers expect to present a revised draft of the 2018/19 statement of accounts to the meeting of the audit committee on 23 April 2020. We agreed with officers that supporting workings for changes made to the original version of the statement of accounts, together with information requested during our on site visit in June to August 2019 will be submitted for audit by 29 May 2020. On this basis we propose to re-commence our work on the 2018/19 accounts over the summer. This means that our work on the 2018/19 accounts will need to be carried out in the same or similar period to our work on the 2019/20 accounts. We agreed with officers that it is not practicable for both audits to be complete by the usual target date of 31 July (even in normal circumstances). Subsequently, the publication date for the 2019/20 accounts is expected to move to 30 November and changes and the earlier publication deadline of 31 May for the draft statement of accounts is expected to move to 31 August. The situation remains fluid at the time of writing and we will finalise our plans once the whole of the national timetable, and Council's response to this, is known. We anticipate, based on the assumption that good quality information is provided, that a period of four months will be required to complete the audits of both years. However, the impact of the disruption which Covid-19 may cause to the accounts and audit process is difficult to foresee and if activity is delayed into the autumn as a result of the current crisis, this may also create scheduling problems which may result in a longer timeframe for the audit process.
Areas of focus in our work on the accounts	In our audit planning report last year, we identified the following areas of significant audit risk which we expect to remain as significant risks of material misstatement in the 2019/20 statement of accounts: • 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. We have also provisionally identified a significant risk of material misstatement in the recognition of income from grants and other contributions. This balance is not inherently complex and does not involve significant judgement. However, our 2018/19 audit procedures performed to date have identified a number of errors arising from either use of the wrong recognition basis or inadequate reconciliation processes for related balance sheet codes.

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 risk assessment to determine whether there are any further significant risks is at a very early stage and is again impacted by the status of our work on the 2018/19 audit. We ordinarily consider that where a matter has given rise to a qualification of our VFM conclusion in the prior year, there is a significant risk that the matter is also relevant to the current year. Our predecessor qualified his report in relation 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 expect that our 2018/19 VFM conclusion will be qualified in this respect as it is apparent from Ofsted's monitoring reports in the earlier part of the year under audit that Ofsted's concerns were still being addressed. In view of the progress shown in the later monitoring reports, and reflected in the rating of "Good" in Ofsted's re-inspection of the service in June 2020, we do not consider this to be a significant risk for our 2019/20 audit. The Council has identified issues in its administration of the pension scheme and reported on a significant control weakness in respect of financial reporting in its updated Annual Governance Statement. We will evaluate whether these represent a significant risk in respect of both 2018/19 and 2019/20 VFM conclusions.

Our audit of the statement of accounts explained

We tailor our audit to your Authority

Identify changes in your business and environment

The Council achieved a rating of "Good" in Ofsted's re-inspection of its childrens services. The Council has continued works on its new Town Hall.

There are no significant changes to local government accounting in 2019/20, but the Council is required to make disclosures about the impact of IFRS 16 Leases on future years' accounts.

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.

Identify changes in your business and environment → Determine materiality → Scoping → Significant risk assessment → Conclude on significant risk areas → Other findings → Our audit report

Determine materiality

Last year we determined materiality to be £25m, representing 2% of estimated gross spend on services and expect to determine materiality at a similar level for 2019/20.

We will set a threshold to report any uncorrected misstatement misstatements to the audit committee and expect this to be similar to last year's threshold of £1.25m.

Significant risk assessment

We have included recognition of income from grants and contributions as a significant risk this year.

Other areas of significant risk so far identified are the same as the previous year.

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 will consider the findings from their work as part of our risk assessment and where significant control weaknesses are identified, 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. This is based on an assumed start date of 1 June 2020 and may need to be flexed in the event of a later start date.

Planning fieldwork	**Planning fieldwork**	**Year end fieldwork**	**Other reporting**	**Post reporting activities**
• Determine overall scope and timetable for the audit • Preliminary assessment of materiality • Preliminary identification of risks of material misstatement	• 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)
Planning report to the Audit Committee	Planning report to the Audit Committee	Final report to the Audit Committee	Annual audit letter	Any additional reporting as required
Jan 2020 – April 2020	**Jan – June 2020**	**June – Sept 2020**	**Oct 2020**	**Oct – Nov 2020**

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

Our risk assessment process is in progress and will need to be finalised in the light of the outcome of officers' work on issues identified in relation to the 2018/19 accounts.

We expect that risks identified as significant audit risks in our planning report remain significant audit risks in 2019/20, noting in particular the size of the capital programme in 2019/20 and the incidence of error in the prior year property valuation. We have also provisionally identified a new significant audit risk in relation to the recognition of income from grants and contributions. This is not an inherently complex or judgemental balance and we therefore expect to pinpoint the risk to aspects which have rise to these issues, in particular determining the appropriate recognition basis and reconciliation of grant control accounts.

Red or amber risks (Q3)

- Death or serious harm to child or vulnerable adult
- Brexit impacts
- Tower block residents are not/do not feel safe
- ICT risks not managed corporately

IAS 1 Critical accounting estimates (2019 draft statement of accounts)

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

Key finance metrics

- The Council expects to be overspent by £11m, after use of reserves
- Forecast capital spend for 2019/20 is £217m

Prior year significant audit risks (financial statements)

- Valuation of properties
- Management override of controls
- Appropriateness of capitalization of expenditure

As commented on last year, the Council is required to report those critical accounting judgements where there is a significant risk of material change in the next year; other items should not be included in the disclosure. We have requested officers to re-look at whether all of these items meet the conditions for disclosure.

Significant risks – statement of accounts
Our risk assessment process

Comments on other audit risks

Last year we concluded that the risk of material misstatement of the pension liability valuation was towards the higher end of the range, but was not a significant risk.

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 had engaged a reputable actuary and there were no significant changes in the membership of the scheme or significant transactions in the pension scheme which impact on the valuation.

In 2019/20, the Council will again need to consider the implications of judgements in the McCloud and Sergeant cases which upheld claimants' cases that the method of implementing career average revalued earnings pension schemes discriminated against younger scheme members.

As details of the remedy for the schemes has not been drafted there is uncertainty about the basis for valuing the impact of these changes.

In the Lloyds Bank High Court case, the judge ruled that all schemes must equalise Guaranteed Minimum Pensions between males and females. This case has clarified 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 used by actuaries to calculate the IAS 19 liability beyond 2021 when the interim measure expires.

We will reassess whether there is a significant audit risk in relation to the valuation of pension liabilities depending on developments in these areas and on initial information received from the actuary.

Significant risks – statement of accounts

Risk 1 – Property valuation

Risk identified	The Council held dwellings of £1.0bn and other land and buildings (principally schools) of £1.2bn at 31 March 2019 (according to the original version of the draft financial statements) which are required to be recorded at current or fair value at the balance sheet date. The Council's past practice has been 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. In these circumstances a judgement needs to be made as to whether there has been a material change in value since the last valuation date. Valuations involve a number of management and specialist assumptions such as the size and design of modern equivalent assets for schools and selection of appropriate comparators for residential valuations which gives involves significant judgement. The Covid-19 has caused significant uncertainty over valuations at 31 March 2020.
Our response	We will test the design and implementation of key controls in place around the property valuation. We remind the audit committee this is an area where we reported in July 2019 on significant control deficiencies and where subsequent investigations identified material errors in the original valuation. We would expect officers to put in place effective controls, including controls over: the completeness and accuracy of factual information provided to the valuer (e.g. land areas); subjective inputs (e.g. selection of appropriate modern equivalent assets and their consistency with service objectives); the reasonableness of the outcome of the valuation; and the accuracy of postings. 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. We will evaluate the uncertainty over asset valuations caused by Covid-19 and the approach adopted by the valuer. We will also consider any disclosures the Council has made regarding these disclosures. We will consider the impact of this uncertainty on our audit report. 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, 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 – Inappropriate capitalisation of expenditure

Risk identified	The Council has a substantial capital programme of £0.6bn over the next three years, including £217m (revised estimate) 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 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 remind the Audit Committee that we reported last year that we were not able to identify any formal controls to mitigate the risk of inappropriate capitalisation of expenditure and recommend that this is put in place. We will select a sample of additions in the year to test whether they have been appropriately capitalised in accordance with applicable accounting requirements.

Significant risks – statement of accounts

Risk 3 – Recognition of income from grants and contributions

Risk identified	Recognition of grant income and contributions is not inherently complex and does not involve significant judgement. However, errors were identified in the recognition of income from grants and contributions in 2018/19, principally as a result of applying the wrong recognition basis, but also because of inadequate control over the reconciliation of control accounts. Misstatements included: • Recording leaseholder contributions to capital projects in the accounts only when invoiced and then deferring recognition in the Comprehensive Income and Expenditure Statement only once the cash received had been from the leaseholder • Recognition of community investment levy on invoicing and not at commencement of the development • Accruing the income to match a deficit on Dedicated Schools Grant • Inappropriately carrying forward of a balance on a control account for PFI grant.
Our response	We have pinpointed the risk of material misstatement to the selection and application of appropriate recognition principles to grants and contributions, other than housing benefit subsidy, and reconciliation of closing control account balance. There is some complexity in calculating the entitlement to benefit subsidy because of the complexity in subsidy rules and volume of transaction, but the recognition principles are straight forward and the history of error (which arises due to errors in the calculation of entitlement and not in applying recognition principles) is low. We will test the design and implementation of controls over the selection and application of appropriate recognition principles and reconciliation of control accounts at year end. As there were large and multiple errors last year, we expect that the Council will need to put in new or changed controls in these areas. We will test the selection and application of appropriate reconciliation of grant income and contribution streams for a sample of grants. We will also test and sample of grant control accounts.

Significant risks – statement of accounts
Risk 4 – 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 gain an understanding of the controls in place • 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

Code of Audit Practice objective

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.

Risk assessment procedures

Our risk assessment procedures include:

- Reading the annual governance statement
- Considering local and sector developments and how they impact on the Council
- Discussions 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.

Status of our risk assessment

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 April and 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.

Risks so far identified for further evaluation

We ordinarily regard qualification issues in the prior year to be significant risks in the current year and 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. The position is not straight forward here as our 2018/19 audit is ongoing.

Childrens services

As indicated in our report to the July 2019 audit committee meeting, we expect to qualify our conclusion in relation to the issues identified by the in a report published by Ofsted on 7 April 2017 which rated children's services in Tower Hamlets as "inadequate" and subsequent quarterly monitoring reports which indicated unresolved issues in the earlier part of 2018/19. Quarterly monitoring in the later part of 2018/19 acknowledged progress made by the Council which was confirmed by an improvement in Ofsted's rating of childrens services to "Good" based an inspection in the period from 10 June 2019 to 21 June 2019. We do not therefore expect to carry this forward as a significant risk in 2019/20.

Value for money conclusion
Our risk assessment process

Financial reporting

The Council's statement of accounts has been significantly delayed and there has been a period of uncertainty over the true financial performance in 2018/19 and amount of resources available at 31 March 2019 while officers investigate and quantify potential or actual misstatements in the draft statement of accounts. The Council has recognised in its updated draft annual governance statement for 2018/19 that there significant deficiencies in controls over financial reporting.

Reliable and timely financial reporting that supports the delivery of strategic priorities is a key component of informed decision-making. We will evaluate whether these circumstances present a significant risk.

Pension administration

Where other matters come to our attention which are relevant to the discharge of our duties in respect of VFM arrangements under the Code, we are also required to consider their impact on the risk assessment, irrespective of whether or not the issue is explicitly referenced within the scope of proper arrangements.

The Council has needed to report various matters to the Pensions Regulator. The which the Council has for managing the pension fund are relevant to our overall risk assessment and we will consider whether the significance of matters reported to the Pension Regulator present a significant risk. In doing this we will also consider whether and how the Council has responded to learnings from the Pension Regulator's report: "Governance and administration risks in public service pension schemes: an engagement report".

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 | 6 May 2020

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 2020 in our final report to the Audit Committee.
Non-audit fees	We carried out certification work during 2019/20 in respect of the Council's 2018/19 return to the Teachers Pension Scheme and 2018/19 housing benefit subsidy return to the Department for Works and Pension to assist the Council in complying with their reporting requirements to these bodies. Information on the fees charged for this work is set out on the next page. The work on the equivalent returns in respect of 2019/20 will be carried out by a different reporting accountant and not us. There were 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 current fee scale rates for the audit of the Council and the pension scheme which it administers are as follows:

	Current and prior 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**

The scale rates are based on certain assumptions and are subject to variation, with the agreement of the Council and approval of Public Sector Audit Appointments Limited (PSAA), where those assumptions do not hold.

We have summarised the assumptions applicable to 2019/20 on the next page which in particular assume that the draft statement of accounts and supporting working papers are of good quality, they are provided by the agreed dates and that subsequent audit requests are responded to on a timely basis and, again, with good quality information and explanations.

These assumptions did not hold true for the 2018/19 audit: the accounts, whilst provided at the start of the visit, contained many account balances and disclosures which were misstated by amounts which were more than clearly trivial, including items which were materially misstated; some issues appear to be longstanding and have required investigation of prior periods; requested information was not available at the start of the audit and was in many cases not of good quality and required further analysis; there were very long delays in receiving responses to audit requests (and indeed there is a significant list of open requests for information which is yet to be provided). As a consequence, we extended our field team visit to the end of August 2019, increased the involvement of senior staff and have continued to input time on and off site subsequently.

We estimate additional costs incurred to date on the Council audit (using the rate card for fee variations contained in PSAA's Terms of Appointment) to be £40,000. A payment on account for this amount is subject to approval by PSAA. We expect to agree a further variation to the scale rate for 2018/19 for the cost of the additional time which will be spent over the summer in finalising the 2018/19 audit using that same rate card. We expect this additional cost to be in excess of £100,000. This includes additional work to respond to additional or heightened risks identified from the work carried out so far, but indication of the likely level of further fees assumes that the remaining work can be carried out without further delay or new issues arising. We also expect to request an additional fee for the pension scheme where our costs have been higher as a result of similar issues.

Our costs for the 2019/20 will be higher than the current scale rate as we need to respond to additional or heightened risks across a range of individual account balances, and for the accounts as a whole, as a result of the experience of error in 2018/19. We estimate (based on the assumption on the next page) that the additional fee required for this work will be £50,000.

Appendix 2 - Fees

Assumptions on which the fee for the 2019/20 audit is based:

- The draft statement of accounts is available in line with the publication timetable applicable to 2019/20
- The draft statement of accounts meets the presentation and disclosure requirements applicable to local authority accounts for 2019/20.
- The accounts are of good quality. For this purpose we have assumed that the accounts are free from material error and contain no more than 3 misstatements other than those which are clearly trivial.
- Information included in narrative reports accompanying the financial statements are consistent with the financial statements.
- The initial set of supporting work papers and other documentation requested by us for the audit of the financial statements is available at the start of our final audit visit and is of good quality.
- Information and explanations which are subsequently requested are provided to us on a timely basis, ordinarily within 48 hours of the request, unless the request is substantial or complex and a longer period is agreed between us for that request. The information provided is of good quality.
- Documentation (including, for material estimates) management of prepared to support and explain material accounting judgements. Management papers should include as a minimum: calculation of estimate; accuracy of past estimates using the same methodology; source of factual inputs and controls over the completeness and accuracy of that information; rationale and support for subjective inputs and assumptions, including evaluation of any contradictory evidence.
- No significant risks are identified in relation to our conclusion on the Council’s arrangements to secure economy, efficiency and effectiveness in its use of resources.
- There are no breakdowns in internal control which impact on the scope of our work and recommendations made last year in relation to financial reporting have been implemented in full.

Appendix 2 - Fees

The professional fees charged by Deloitte in the period from 1 April 2019 to 31 March 2020 for non audit services were as follows:

	Current year £'000
Report on the Council's 2018/19 housing benefit return based on agreed upon procedures	24
Limited assurance report on the Council's 2018/19 return to the Teachers Pension Scheme	5
Total non audit fees	**29**

In 2018/19 we 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.

Appendix 3 – Developments in financial reporting

We have set out below developments which may impact on the 2019/20 and future years' statement of accounts.

2019/20 accounting code	CIPFA/LASAAC has made several changes to the previous version of the accounting code (which was applicable to 31 March 2019 year ends) which: augmented the description of adaptations and interpretations in the code; made changes to reflect the issue of the IASB's 2018 IFRS Conceptual Framework; included new guidance on the treatment for the apprenticeship levy; incorporated amendments to IFRS 9 Financial Instruments in respect of prepayment features in loans; and clarified interpretations in relation to group accounts and LOBOs.	The principal updates to the accounting code in 2019/20 are either not relevant to the current circumstances of the Council or are not expected to have a material impact.

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 beyond 2021 when the interim measure expires.	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.
Transitional protection for certain pension scheme members	In December 2018, the Court of Appeal ruled that the transitional protection offered to some members of the judges and firefighters pension schemes as part of the reforms amounts to unlawful discrimination, through respectively the McCloud and Sergeant cases. The government confirmed in a written statement to Parliament that the implications of the McCloud case also applied to both the Local Government Pension Scheme. It is unlikely that restitution for the LGPS will be determined during 2020.	The Council concluded in 2018/19 that the effect would be immaterial. The key drivers for this were the below average age of the current membership and the Council's expectation of future salary increases, which were towards the bottom end of a reasonable range. The Council will need to assess whether this is still the case for their 2019-20 financial statements.

Appendix 3 – Developments in financial reporting

Dedicated Schools Grant	Local education authorities receive Dedicated Schools Grant (DSG) from the Department for Education (DfE), which is a ring-fenced grant, to fund schools. Authorities are required to keep a separate reserve to show any unspent DSG. DfE clarified in 2018-19 that this reserve could not be netted off with schools' balances. For some authorities the DSG reserve is now negative, meaning that the authority has spent more than the grant it has received. DfE clarified in 2018-19 that this reserve could not be netted off with schools' balances. For some authorities the DSG reserve is now negative, meaning that the authority has spent more than the grant it has received. DfE decided to update the conditions of grant and introduce a statutory requirement that any DSG deficit could not be funded from general fund. The School and Early Years Finance (England) Regulations 2020 (the regulations) require from 1 April 2020 that a DSG deficit must be carried forward to be dealt with from future DSG income, unless the Secretary of State authorises the authority not to do this. These arrangements apply for setting the authority's 2020-21 budget and mean that a DSG reserve in deficit cannot be funded from the general fund. The same provisions will appear in future regulations so that LAs can continue to carry deficits forward from year to year. The regulations do not set out anything in respect of the accounting for either 2019-20 or 2020-21.	The Council is one of those authorities which is incurring deficits on its DSG funding. In the original draft of the 2018/19 financial statements, the deficit was inappropriately carried forward and not charged. The Council should consider the existing guidance on the accounting and presentation of DSG deficits in finalizing its statement of accounts for 2018/19 and be alert to new guidance in preparing its statement of accounts for 2019/20.

Appendix 3 – Developments in financial reporting

Expected deferral of IFRS 16 Leases to 2021/22	The new leasing standard IFRS 16 Leases will replace IAS 17. The standard was due to be implemented for the 2020-21 financial year, but CIPFA has announced their intention to defer implementation until 2021/22. 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 and other contracts. 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. The expected delay in the implementation date provides more time to prepare. We recommend that this is well used as the Council was not well prepared for the implementation of IFRS 9 Financial Statements and IFRS 15 Revenue in 2018/19.

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. 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.	Parts of the guidance were available for early adoption in from 1 April 2018 but this option was not taken.

Deloitte.