Arun District Council
Audit planning report update

Year ended 31 March 2020

June 2020

Members of the Audit and Governance Committee

30 June 2020

Arun District Council
Civic Centre
Maltravers Road
Littlehampton
BN17 5LF

Dear Audit and Governance Committee Members

Audit Planning Report update – Year ended 31 March 2020

This report seeks to provide the Corporate Governance and Audit Committee with an update to our risk identification for the 2019/20 audit, reflecting the changes in risks identified in the current year.

In our audit planning report submitted for the 13 February Audit and Governance Committee, we provided you with an overview of our audit scope and approach for the audit of the financial statements. Following the coronavirus outbreak (Covid-19) in March 2020, we have since re-assessed our audit scope and strategy. We provide an update to the significant accounting and auditing matters, and audit approach outlined in the Audit Planning Report.

If you have any queries in respect of this report, please contact me.
Yours faithfully

Kevin Suter

For and on behalf of Ernst & Young LLP

01 Audit risks

Our response to significant risks

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

Inappropriate capitalisation of revenue expenditure

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We have identified an opportunity and incentive to capitalise expenditure under the accounting framework, to remove it from the general fund. This would result in funding expenditure that should properly be defined as revenue, through inappropriate sources such as capital receipts, capital grants, or borrowing. We believe the significant risk manifests itself within PPE additions and REFCUS.

Update – Covid-19 expenditure

No change to the risk from Covid-19 in 2019/20 and no change to planned procedures.

Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. We focus our testing on capital additions (£5.54m in 2019/20) and Revenue expenditure funded from capital under statute (REFCUS) (£2.18m in 2019/20).

Other areas of audit focus

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

What is the area of focus?	What will we do?
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. Update – Covid-19 related constraints on property valuation The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, has issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. This impact is expected to affect PPE valued at Existing Use Value (EUV) as the valuation basis for these properties are linked to recent market transactions. Caveats around this material uncertainty have been included in the year-end valuation reports produced by the Council's external valuer.	We will: • Consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer; • Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. • Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated; and • Test accounting entries have been correctly processed in the financial statements. Additional Covid-19 procedures in response to our risk include: • Consider the Council's asset base by type of asset and valuation methodology, as impacts are likely to be more significant for assets valued on the basis of data from market transactions; • Ensure the appropriate disclosure has been made in the accounts concerning the material uncertainty, including in Note 4 'Assumptions made about the future and other major sources of estimation uncertainty'; and • If required, obtain input from EY Real Estates, our internal specialists on asset valuations for PPE, including inputs on market sentiment and how it has been reflected in valuations which are based on EUV and fair value.

Other areas of audit focus (continued)

What is the area of focus?	What will we do?
Covid-19 has created a number of financial pressures throughout Local Government, increasing service demand and increased expenditure. The Council has incurred additional expenditure in housing rough sleepers and has experienced some income losses in parking and leisure services. There is currently not a clear statement of financial support from MHCLG that covers all financial consequences of Covid-19. There have been a number of media stories in both the national press and trade publications raising the possibilities of an increase in Chief Financial Officers using their s114 powers. This could be under s114(3), insufficient resources to fund likely expenditure. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements. The auditor's report in respect of going concern covers a 12-month period from the date of the report, therefore the Council's assessment will also need to cover this period.	In light of the unprecedented nature of Covid-19, its impact on the funding of public sector entities and uncertainty over the form and extent of government support, we will be seeking a documented and detailed consideration to support management's assertion regarding the going concern basis and particularly with a view whether there are any material uncertainties for disclosure. We will review your updated going concern disclosures within the financial statements under IAS1, and associated financial viability disclosures within the Narrative Statement. We expect you to disclose any material uncertainties that do exist. These disclosures should also include the process that has been undertaken for revising financial plans and cashflow, liquidity forecasts, known outcomes, sensitivities, mitigating actions including but not restricted to the use of reserves, and key assumptions (e.g. assumed duration of Covid-19). Our audit procedures to review these will include consideration of: • Current and developing environment; • Liquidity (operational and funding); • Mitigating factors; • Management information and forecasting; and • Sensitivities and stress testing.

Audit risks

Other areas of audit focus (continued)

What is the area of focus?	What will we do?
New accounting standard – IFRS 16 In our Audit Planning Report drafted in January we identified an inherent risk in relation to the implementation of the new accounting standard on leases. Due to the impact Covid-19, the adoption of IFRS 16 (Leases) was deferred to 21/22.	Since IFRS 16 (Leases) has not yet been adopted by the Code, the Council no longer needs to disclose the financial impact of this new accounting standard in the 19/20 accounts. We therefore no longer consider this to be an areas of audit focus.

Additional Procedures

Audit Process overview

Additional audit procedures as a result of Covid-19

Other changes in the entity and regulatory environment as a result of Covid-19 that have not resulted in an additional risk, but result in the following impacts on our audit strategy are as follows:

- Information Produced by the Entity (IPE): There is an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the likely inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We will:
    - Use the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we're auditing; and
    - Agree IPE to scanned documents or other system screenshots.
- Additional EY consultation requirements concerning the impact on auditor reports.

The changes to audit risks and audit approach will change the level of work we perform. This may impact the audit fee. We will agree changes to the audit fee with management and report back to the Audit and Governance Committee in our Audit Results Report.

Materiality

Materiality

We have considered the materiality levels we reported to you in our Audit Planning Report, and whether any change to our materiality is required in light of Covid-19. Following this consideration we remain satisfied that the values for planning materiality, performance materiality and our audit threshold for reporting differences reported to you in our Audit Planning Report remain appropriate.