Watford Borough Council

Audit planning report

Year ended 31 March 2019

February 2019

Building a better working world

27th February 2019

Watford Borough Council
Town Hall, Hempstead Road,
Watford
WD17 3EX

Dear Audit Committee Members

Audit planning report

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

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

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

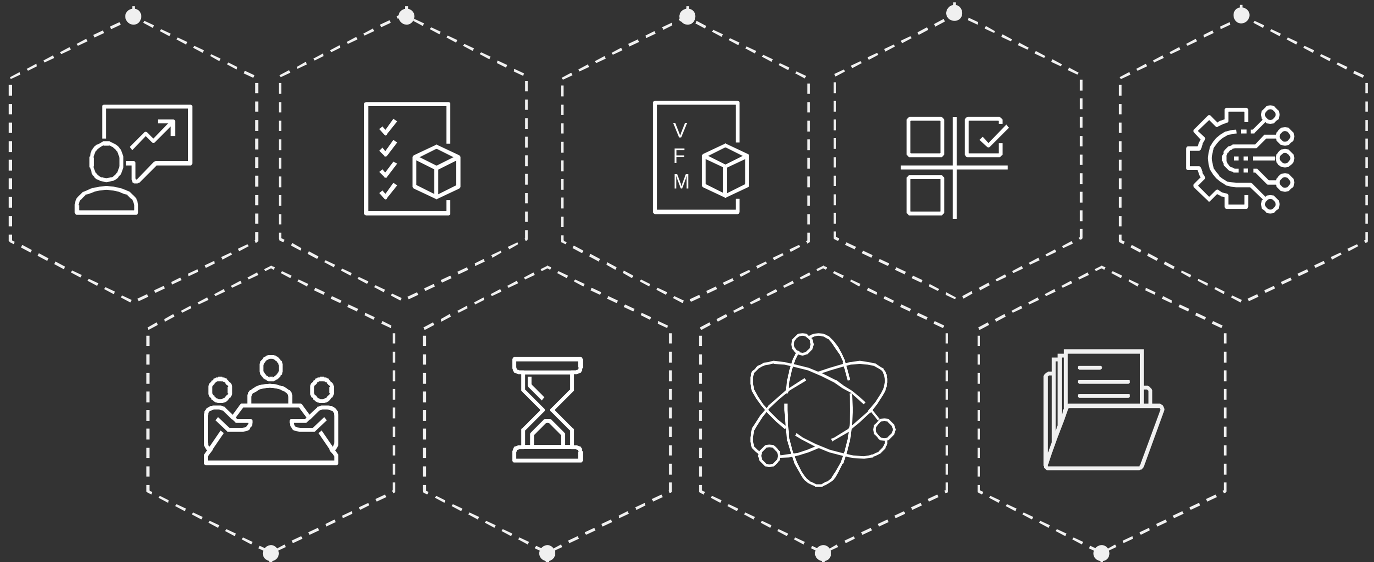
We welcome the opportunity to discuss this report with you on 14th March 2019 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Maria Grindley

For and on behalf of Ernst & Young LLP

Contents



Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.
The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.
This report is made solely to the Audit Committee and management of Watford Borough Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Watford Borough Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Watford Borough Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2018/19 audit strategy

Overview of our 2018/19 audit strategy

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

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error*	Fraud risk	No change in risk	Misstatements that occur in relation to the risk of fraud due to management override could affect a number of areas of the financial statements. We believe this manifests itself in the accounting for manual journals and income from investment and leasehold property – see below.
Incorrect accounting for manual accruals*	Fraud risk	No change in risk	Misstatements that occur in relation to the risk of fraud or error in revenue and expenditure recognition could affect income and expenditure accounts. We believe that this risk is likely to manifest itself in the accounting for manual accruals.
Incorrect accounting for income from investment and leasehold properties*	Fraud risk	Increase in risk or focus	Misstatements that occur in relation to the risk of fraud or error in revenue and expenditure recognition could affect income and expenditure accounts. We believe this risk is likely to manifest itself in the accounting for income from investment properties and leasehold properties.
Acquisition of Leasehold Interest in Croxley Business Park	Significant risk	New risk	During 2018/19, an opportunity was presented to Watford Borough Council to acquire a 40 year head lease at Croxley Business Park. Broadly, the accounting will be to recognise an asset of circa £0.3bn within Property, Plant and Equipment and as a long term lease liability. This transaction is not yet complete so we have raised the significant risk at this stage and will keep this under review and will complete work on the accounting treatment should this transaction take place before the 31st March 2019 year end.

Overview of our 2018/19 audit strategy

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

Risk / area of focus	Risk identified	Change from PY	Details
Valuation of Other Land and Buildings	Inherent risk	No change in risk	Management is required to provide material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. Detailed valuation work is undertaken by the Council's valuers Bilfinger GVA.
Other Additions to the Capital Programme	Inherent risk	No change in risk	Even with routine capital acquisitions and enhancements, there is an inherent risk that revenue expenditure (e.g. repairs and maintenance) could be incorrectly capitalised.
Valuation of Pension Fund Assets and Liabilities	Inherent risk	No change in risk	Asset and Liability values captured in Watford Borough Council's 2018-19 accounts will derive from information issued to the Council by the actuary to Hertfordshire County Council and will involve significant estimation and judgement.
Valuation of NNDR Appeals Provision	Inherent risk	Reduced risk compared to prior year	Watford Borough Council's NNDR Appeal Provision was valued at £6,831,000 at 31 March 2018. This is a high value estimate driven by complex calculations.
New Accounting Standards	Inherent risk	New area of focus	New accounting standards are applicable for local authority accounts from the 2018/19 financial year and will bring a number of new requirements.

Overview of our 2018/19 audit strategy

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

Area of interest	Interest	Change from PY	Details
Group Accounting	Inherent risk	No change focus	This is subject to the Croxley Park transaction and we will assess the scope of group audit work once the impact of the acquisition of Croxley Business Park head lease is known. If appropriate, we will review proposed consolidation accounting entries before the start of the year end audit and confirm that the proposed method of group accounting is appropriate for the relative size of the year end group.

Materiality

Planning materiality
£1.7m

Materiality has been set at £1,733,000, which represents 2% of the prior years gross expenditure on provision of services.

Performance materiality
£867k

Performance materiality has been set at £867,000, which represents 50% of materiality.

Audit differences
£87k

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement and collection fund) greater than £87,000. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Committee.

Overview of our 2018/19 audit strategy

Audit scope

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

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

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

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

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

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

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

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

Audit team changes

Key changes to our team.

Associate Partner - Maria Grindley replaces Andrew Brittain as Associate Partner.

Manager - Jo Taylor replaces James Bundy as Manager.

Key team members include Samantha Wileman and Umber Irshad, both of whom have worked with the Council before. Jessal Raja will also be joining them as a key team member.

02 Audit risks

Our response to significant risks

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

Misstatements due to fraud or error*

Financial statement impact

Misstatements that occur in relation to the risk of fraud due to management override could affect a number of areas of the financial statements.

What is the risk?

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

We identify and respond to this risk on every audit engagement.

We believe this risk manifests itself in two areas: accounting for manual journals and investments and long term property revenues – separate risks have been raised for each of these areas.

What will we do?

- Inquire of management about risks of fraud and the controls put in place to address those risks;
- Understand the oversight given by those charged with governance of management's processes over fraud; and
- Consider of the effectiveness of management's controls designed to address the risk of fraud.

Perform mandatory procedures regardless of specifically identified fraud risks, including:

- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;
- Assessing accounting estimates for evidence of management bias; and
- Evaluating the business rationale for significant unusual transactions.

We will utilise our data analytics capabilities to assist with our work, including carrying out testing on the income and expenditure accounts and journal entry testing.

Our response to significant risks

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

Incorrect accounting for manual accruals*

Financial statement impact

Misstatements that occur in relation to the risk of fraud or error in revenue and expenditure recognition could affect income and expenditure accounts. Manual accruals is one of the relevant accounts we associate revenue and expenditure recognition risk to. Manual accruals supported the following balances in the 2017-18 financial statements:

Net cost of services expenditure: £34,945,000.

Manual accruals: £2,700,000.

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.

In considering how the risk of management override may present itself, we conclude that this is primarily through management taking action to override controls and manipulate in year financial transactions that impact the financial position.

A key way of improving the revenue position is through inappropriate timing or measurement of estimates, manual accruals around the year end being a typical estimate that could be affected.

What will we do?

We will focus our journals testing strategy around the year-end period, with a particular focus on those manual entries that impact income and expenditure.

Where there is any management estimation or assumptions involved in the calculation of year end accruals we will ensure that the rationale provided by management is appropriate and clearly documented on file via minutes of conversations held by management.

Our response to significant risks

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

Incorrect accounting for income from investment and leasehold properties*

Financial statement impact

Misstatements that occur in relation to the risk of fraud or error in revenue and expenditure recognition could affect income and expenditure accounts. Income from Investment Properties and Leasehold Properties is one of the relevant accounts we associate revenue and expenditure recognition risk to. Such income supported the following balances in the 2017-18 financial statements:

(Income) / Expenditure in relation to investment property: £6,885,000.

Total Reserves: £214,535,000.

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.

In considering how the risk of management override may present itself, we conclude that this is primarily through management taking action to override controls and manipulate in year financial transactions that impact the financial position.

A key way of improving the revenue position is through the inappropriate recognition of Investment property rental income from the properties held by the council and from leasehold properties.

We note that whilst such Income may have been £6,885,000 in 2017-18, with the acquisition of Croxley Business Park head lease, this is expected to increase significantly. The acquisition may be completed in the run up to year end and it will be particularly important to ensure that new rental income streams are recognized in the correct year of account.

What will we do?

We will review a sample of investment property and leasehold property income to confirm it is appropriately accounted for, particularly around the year end when Croxley Business Park may have been acquired. We will reconsider this risk when we know more around the timing of this significant transaction.

Audit risks

Our response to significant risks

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

Acquisition of Leasehold Interest in Croxley Business Park

Financial statement impact

During 2018/19, an opportunity was presented to Watford Borough Council to acquire a 40 year head lease at Croxley Business Park. Broadly, the accounting will be to recognise an asset of circa £0.3bn within Property, Plant and Equipment and a corresponding long term lease liability. Acquisition is expected to occur before 31 March 2019 so we will keep this under review until final dates are known.

What is the risk?

The proposal has been structured as an “income strip” deal and the Council will have the option to acquire the freehold of Croxley Business Park at the end of the term. Under the proposal the Council will be entitled for forty years to receive the full passing rental income from occupational tenants on the Business Park in return for paying a rent to the vendor.

At inception, CTi will pay the Council a rental top up sum to cover any rent free periods on occupational leases. CTi will also pay the Council a contribution towards planned and preventative maintenance.

The strategy for valuing and impairing the asset over the forty year life of the agreement will obviously impact on the level of write down or revaluation at the end of that period.

The Minimum Revenue Provision made by the Council in connection with this agreement is expected to cover fifty years, in recognition that the life of the asset is expected to outstrip the life of the leasehold agreement with CTi.

The high value of the transactions will significantly impact on the Council’s Balance Sheet. There is a risk that financial performance could be distorted or that the oversight of financial reporting in other areas of the account could be affected by the workload of bringing this complex transaction to account at the year end.

What will we do?

We are currently waiting to see what progress is made by the year end and will then complete our work depending on whether the deal progresses prior to the 31 March year end. If it does we will consider the implications depending on what has happened by the year end.

For the financial statements, we will review closely the proposed accounting for Property, Plant and Equipment and Long Term Liabilities. If necessary, we will liaise with specialist EY valuer colleagues. We will also review the accounting treatment in year for the payments received from CTi and all associated presentation and disclosure in the notes to the accounts.

We will review the proposed strategy for writing down and revaluing the asset over the ensuing forty year period.

We will review presentation and disclosure across the year end draft accounts and we will be mindful of the potential impact in other areas of the financial statements. In particular, we will be mindful of the impact on scoping group accounts.

Finally, we will remain alert to the risk that this deal could create new related parties and that if it does, disclosure of transactions with those related parties will need to be considered.

Other areas of audit focus

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

What is the risk/area of focus?	What will we do?
Valuation of Other Land and Buildings Land and Buildings within Property, Plant and Equipment were valued at £80,023,000 at 31 March 2018 and Investment Properties were valued at £168,950,000 as at that date. These represent significant balances in Watford Borough Council's accounts and will be subject to valuation changes. Management is required to provide material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. Detailed valuation work is undertaken by the Council's valuers Bilfinger GVA. Bilfinger GVA plan to undertake detailed revaluation work at the end of December and the Council plans to apply an adjustment to reflect estimated valuation movements in the last three months of the year. We note that on 29th March 2019 the UK is scheduled to leave the European Union and that fluctuations in value may be more difficult to predict around this time.	We will: • Consider the work performed by the Council's valuers Bilfinger GVA, including the scope of the work performed on valuations at 31 December 2018 and a comparison of valuation findings with market trends and Land Registry data; data and assumptions used by the valuers; and qualifications and expertise; • Confirm effective procedures are applied by the Council to roll forward valuations from 31 December 2018 to the year end; • 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 and annually for Investment Properties. We will also consider if there are any specific changes to assets that have occurred and that these have been communicated to the valuer; • Review any assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated. Consider changes to useful economic lives as a result of the most recent valuation; • Test accounting entries have been correctly processed in the financial statements; • Review valuer reports and findings to determine whether specialist EY valuer review of methodologies, data and assumptions is required; and • Horizon scan and potentially seek auditor expert input to determine whether fluctuations captured by the Council are in line with wider movements across the UK economy as the country leaves the European Union.
Other Additions to the Capital Programme 2017-18 saw Additions to the Capital Programme of £6,711,000. Even with routine capital acquisitions and enhancements, there is an inherent risk that revenue expenditure (e.g. repairs and maintenance) could be incorrectly capitalised.	We will: Sample test additions to Property, Plant and Equipment to confirm they meet appropriate criteria for capitalisation.

Audit risks

Other areas of audit focus

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

What is the risk/area of focus?	What will we do?
Valuation of Pension Fund Assets and Liabilities The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hertfordshire County Council. Watford Borough Council's pension fund assets and liabilities are material estimated balances and the Code requires that the liability be disclosed on the Council's balance sheet. At 31 March 2018 the net liability was valued at £58,049,000. As noted in our Audit Results Report for 2017-18, this balance was stated gross of an adjustment to increase pension fund asets by £1,800,000, being Watford's share of the difference between the actuary's valuation of the Pension Fund's assets and the Fund's auditor's assessment of those asset values. Asset and Liability values captured in Watford Borough Council's 2018-19 accounts will again derive from information issued to the Council by the actuary to Hertfordshire County Council and will again involve significant estimation and judgement. We note that on 29th March 2019 the UK is scheduled to leave the European Union and asset values may be particularly difficult to estimate around this time. We note also that ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: • Liaise with the auditors of Hertfordshire County Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Watford Borough Council; • Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used; • Review and test the accounting entries and disclosures made within Watford Borough Council's financial statements in relation to IAS19; and • Horizon scan and potentially seek auditor expert input to determine whether fluctuations captured by the Council are in line with wider movements across the UK economy as the country leaves the European Union.
Valuation of NNDR Appeals Provision Watford Borough Council's NNDR Appeal Provision was valued at £6,831,000 at 31 March 2018. This is a high value estimate driven by complex calculations.	We will: • Consider the work performed by Inform, including the scope of the work, data provided to Inform and assumptions used; and • Compare the level of appeals at 31 March 2019 and 31 March 2018 to assess the reasonableness of amounts provided for at year end.

Other areas of audit focus

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

What is the risk/area of focus?	What will we do?
New Accounting Standards IFRS 9 financial instruments This new accounting standard is applicable for local authority accounts from the 2018/19 financial year and will change: • How financial assets are classified and measured; • How the impairment of financial assets are calculated; and • The disclosure requirements for financial assets. There are transitional arrangements within the standard; and the 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 9. However, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty on the accounting treatment.	We will: • Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; • Consider the classification and valuation of financial instrument assets; • Review new expected credit loss model impairment calculations for assets; and • Check additional disclosure requirements.
IFRS 15 Revenue from contracts with customers This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue will change and new disclosure requirements introduced.	We will: • Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19. This will include Local Authority Trading Companies consolidated into the Authority's Group Accounts; • Consider application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and • Check additional disclosure requirements.

Other areas of audit focus

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

What is the risk/area of focus?	What will we do?
Group Accounting Watford Borough Council holds a 50% interest in Watford Health Campus Partnership LLP and Hart Homes (Watford) Limited. Both are consolidated into the financial statements using the equity method of accounting. In the 2017-18 draft financial statements, an alternative set of accounting entries had initially been applied. As the 2017-18 Audit Results Report showed, adjusting entries were subsequently made, resulting in both prior and current year adjustments. We note that the timing of PWC providing an opinion on Watford Health Campus Partnership's accounts meant that the Council missed the 31 July deadline for filing it's own audited group accounts.	We will: We will assess the scope of group audit work once the impact of the acquisition of Croxley Business Park head lease is known. We will review proposed consolidation accounting entries before the start of the year end audit and confirm that the proposed method of group accounting is appropriate for the relative size of the year end group. We will liaise early with PWC regarding timetable for group audit returns and monitor receipt of returns throughout the audit process.

03 Value for Money Risks

Value for Money

Background

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

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

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

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

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

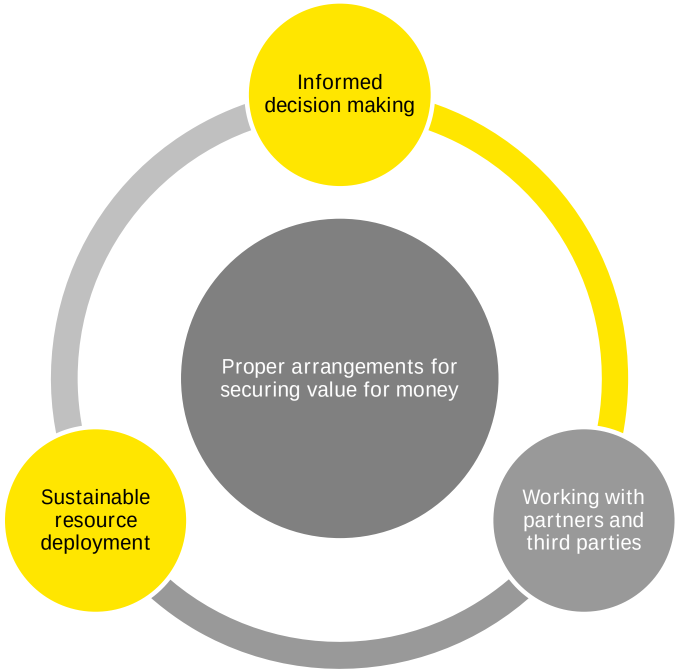
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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

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

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

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of the significant risks noted on the following page which we view as relevant to our value for money conclusion.



Value for Money Risks

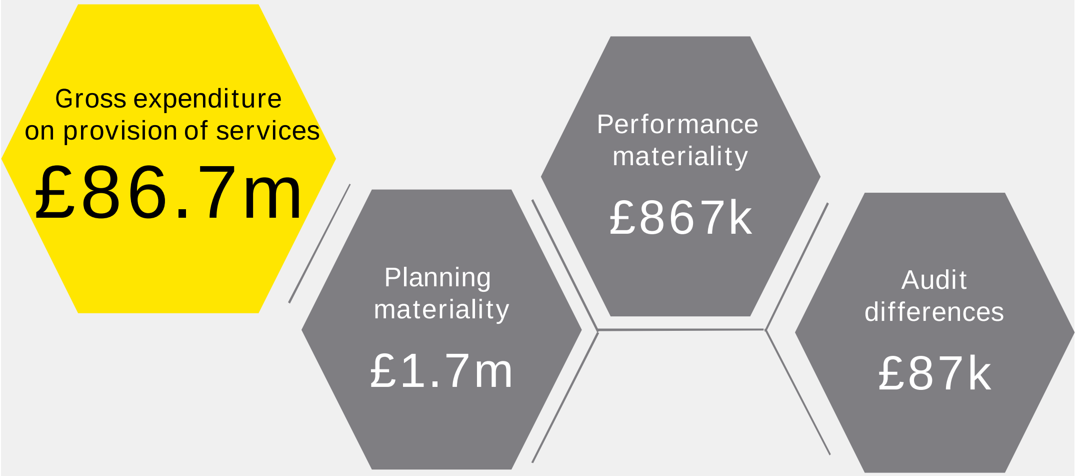
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Acquisition of Leasehold Interest in Croxley Business Park As noted earlier in this report, a high value head lease acquisition opportunity was presented to the Council in the closing part of 2018/19. The acquisition of the head lease represents a forty year commitment that will significantly change the pattern of the Council's cash flows. It will be important that robust processes support decision making on the deal and that the impact on medium to long term financial resilience is understood by those making the decision. The Council commissioned specialist input from a number of sources, including: • Grant Thornton for financial modelling and accounting advice; • Link Asset Services for treasury advice; • Towers and Hamlin LLP for due diligence, procurement, and governance advice; • Chapman Petrie LLP for validation of assumptions used by other specialists; • Lambert Smith Hampton Investment Management and Building Services for market and letting advice and due diligence; and • Montague Evans- service charge analysis focusing on appropriate market supportable levels of service charge. The scope of work commissioned; the amount of time available for analysis; the quality of information provided to specialists; and the effectiveness of the Council's processes for evaluating specialist findings will all impact on the ultimate quality of processes followed to secure value for money for the Council and it's stakeholders,	Arrangements potentially affected are the Council's ability to: • Take informed decisions; and ▪ Deploy resources in a sustainable manner.	Subject to the transaction taking place before the year end our approach will focus on: Quality and timing of advice and discussion and evaluation supporting the decision making process. We will review findings the Council receives from specialists and consider: Their terms of reference and scope of work; the amount of time available for analysis; the quality of information provided to specialists; and the effectiveness of the Council's processes for evaluating specialist findings before reaching a final decision. Assessing the effectiveness of longer term procedures put in place for responding to leasehold occupancy and rental income information as it emerges. Obtaining and reviewing the February 2019 Treasury Management Strategy paper. Assessing the quality of information supporting that paper and the potential impact of any future borrowing plans on financial resilience. Evaluating wider arrangements to ensure financial resilience of the Council, considering factors affecting future spending and the UK economy as a whole (including for example, the departure of the UK from the European Union). We will review the impact of any deal entered into on the Council's financial resilience as part of our value for money testing.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2018/19 has been set at £1,733,000. This represents 2% of the Council's prior year gross expenditure on provision of services. Although there were a series of high value adjustments made to the accounts last year, none indicated underlying entity level control issues. A reduction in performance materiality (from 75% to 50%) and an associated increase in sampling for 2018-19 is expected to provide sufficient assurance to support our work. The 2% materiality threshold will nevertheless be reassessed throughout the audit process.



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

Key definitions

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

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £867,000 which represents 50% of planning materiality. For 2017-18, performance materiality was set at 75% of planning materiality. However, the 2017-18 audit identified a higher than anticipated number of adjusted and unadjusted differences. The reduced threshold for performance materiality will prompt a higher testing level this year in response.

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

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

Group scoping – At this stage of the audit, it is not clear what the impact of the planned Croxley Business Park head lease will be on materiality and group scope. Watford Health Campus LLP was in scope for group audit purposes last year but with a planned addition to Property, Plant and Equipment of some £296,000,000, the scope will need to be re-assessed.

Specific materiality – We have set a materiality of £1 for remuneration disclosures , related party transactions, members' allowances and exit packages which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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

We issue an audit report that covers:

1. Financial statement audit

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

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

Procedures required by standards

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

Procedures required by the Code

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

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

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

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

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

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

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

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

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

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

06 Audit team

Audit team

Audit team structure:

Maria Grindley
Associate Partner

Jo Taylor
Manager

Samantha Wileman
Umber Irshad
Jessal Rawa
Senior Team Members

Confirmed Specialist: EY Pensions
Other Specialist to be considered:
- EY Valuations
- EY Technical team - FAAS

Use of specialists

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

Area	Specialists
Valuation of Land and Buildings	Bilfinger GVA. Potentially EY Valuations Team (to be considered upon receipt of Croxley Business Park acquisition data)
Pensions disclosure	Hymans Robertson and EY Actuaries
NNDR Appeals Provision	Inform

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

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

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

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

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

Audit phase	Timetable		Deliverables
Planning: Risk assessment and setting of scopes.	December/ January		
Walkthrough of key systems and processes	December/ January		
Testing of routine processes and controls Interim audit testing	March		
Audit Committee	14 March 2019		Audit Planning Report and interim audit update
Year end early visit	May		
Year end audit Quality Report/Account testing	July		Interim audit update
Year end audit Audit Completion procedures	July		
Audit Committee	30 July 2019		Audit Results Report
Annual Audit Letter	August - October		Annual Audit Letter

08 Independence

Relationships, services and related threats and safeguards

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

Overall Assessment

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

Self interest threats

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

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

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

Management threats

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

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

Other threats

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

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

Other communications

EY Transparency Report 2018

Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2018 and can be found here:

https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

09 Appendices

Appendix A

Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2018/19 accounts of opted-in principal local government and police bodies.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

A breakdown of our fees is shown in the table below.

	Planned fee 2018/19	Scale fee 2018/19	Final Fee 2017/18
	£	£	£
Total Fee – Code work	40,021**	40,021	TBC*
Total audit	0		0
Other non-audit services not covered above (Housing Benefits)	10,602 plus £1,000 to £4,000 per 40+	N/A	15,268
Total other non-audit services	0		0
Total fees	0		0

All fees exclude VAT

*The Scale fee for 2017/18 Code work was set as £51,975. At the time of writing this report, a Scale Fee Variation of £10,732 was under discussion with the PSAA. This reflects the cost of work on (what was last year) a new group component and the prior year adjustments.

** Subject to additional work which may be required in relation to the Croxley Park transaction.

Housing Benefits work for 2018/19 will be conducted by EY under a non-PSAA contract with a fee agreed outside the PSAA Scale Fee arrangements.

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the Council; and
- The Council has an effective control environment.

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

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

Appendix B

Required communications with the Audit Committee

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

Required communications	What is reported?	Our Reporting to you When and where
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Audit results report

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	Audit results report
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	Audit results report
Fraud	• Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud	Audit results report
Related parties	• Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	Audit results report

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report and Audit Results Report
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report
Consideration of laws and regulations	• Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	Audit results report
Internal controls	• Significant deficiencies in internal controls identified during the audit	Management letter/audit results report

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Group audits (if re-assessment of scope confirms group audit required)	• An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work • Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	• Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Audit planning report Audit results report
Certification work	Summary of certification work undertaken	Certification report

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	• Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. • Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. • Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. • Concluding on the appropriateness of management's use of the going concern basis of accounting. • Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. • Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the Audit Committee reporting appropriately addresses matters communicated by us to the Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and • Maintaining auditor independence.

Appendix C

Additional audit information (continued)

Purpose and evaluation of materiality

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

Materiality determines:

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

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