

A photograph of a meeting table with documents and hands pointing at them. The table is white, and there are several sheets of paper with text on it. A person's hand is pointing at a document on the left, and another person's hand is pointing at a document on the right. A smartphone is visible on the table. The background is slightly blurred, showing a person in a yellow shirt.

# **Watford Borough Council**

## **Audit progress update**

Year ended 31 March 2020

23 July 2020



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

23 July 2020

Dear Committee Members

Audit planning report update

We previously presented EY 2019/20 Audit Plan to the March 2020 Committee meeting. This paper provides an update on the status of the audit and considers the known and potential impacts of Covid-19 at this stage on the audit.

The ongoing disruption to daily life and the economy as a result of the Covid-19 virus would be expected to have a pervasive impact upon the finances of the Council. Understandably, the priority for the Council to date has been to ensure the safety of staff and the delivery of business critical activities. However, the financial statements will need to reflect the impact of Covid-19 on the Council's financial position and performance. Due to the significant uncertainty about the duration and extent of disruption, we are using this update to highlight the ways in which it has or could impact the financial statements.

Therefore we are attaching a short update to our plan to be read in conjunction with the original plans submitted. Collectively these set out our updated view on how we intend to carry out our responsibilities as auditor. Whilst our year end audit is now scheduled to start in September, our risk assessment procedures remain ongoing; we will inform the Audit Committee if there are any significant changes or revisions once we have completed these procedures, and provide an update to the members of the Committee.

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

Yours faithfully

Maria Grindley

For and on behalf of Ernst & Young LLP



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# Audit progress update





## Audit progress update

### Status of the audit

Materiality - In our Audit Committee Planning Report, we communicated that our audit procedures would be performed using a materiality of £1.59m, with performance materiality, at 75% of overall materiality, of £1.19m, and a threshold for reporting misstatements of £79.3k. At the time of the interim audit, we were satisfied that this remained the appropriate materiality to use.

During the interim audit visit, we tested income and expenditure and non current asset additions and disposals for the first ten months of the year as well as reviewing the proposed accounting treatment for Croxley Business Park; planning our VFM procedures; and scoping group audit procedures.

On expenditure testing we identified two items of expenditure that represented under-accrued amounts from 2018/19 and at the time of writing this report, we were awaiting further information to determine the cause of these anomalies to support evaluation and determine the most appropriate audit response:

**i). Source Reference Invoice Number: 12883**

**Amount: £43,077.78**

**GL Date: 15/04/2019**

**Invoice Date: 31/03/2019**

**Relates to: Reversal of an accrued invoice from Trowers and Hamlin - reversing amount being £1109.02 different from the original accrual, with no clear reason why.**

**ii). Source Reference Invoice Number: 13171**

**Amount: £21,880**

**GL Date: 13/05/2019**

**Invoice Date: 29/03/2019**

**Relates to: LSHIM Investment Management - professional charges for Project Westgate.**

## Audit progress update

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### Status of the audit

At the time of writing this report, for our review of Croxley Business Park proposed accounting treatment, we were awaiting or have recently received and are considering :

- Instructions to valuers for the 1 April 2020 valuation;
- LSH evidence and reconciliation supporting valuation on acquisition on 26 July 2019;
- Written confirmation that there are no conditions attached to the £4 million Additional Rent Top-Up received at lease inception; and
- An agreed accounting treatment paper for our records.

We will engage with valuation specialist colleagues once the requested items have been received and we aim to conclude on this area before the start of our final audit.

Our VFM planning identified one new VFM significant risk and this is outlined on page 9 of this report.

For our group scoping work, at the time of writing this report, we were awaiting risk assessments completed by the Council for group entities.

With the exception of some follow-up testing required at final audit on classification of PPE additions and tracing Other Income cash receipts, there were no issues arising from our interim audit work. Our final audit is scheduled to start in September 2020.



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## Update on audit risks



## Update on audit risks

The following 'dashboard' summarises audit risks and areas of focus and the significant accounting and auditing matters identified as a result of Covid-19. It seeks to provide the Audit Committee with an overview of any changes in risks identified in the current year.

### Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from 19/20 audit plan	Details
Incorrect accounting for manual accruals - risk of fraud in revenue and expenditure recognition	Significant	No change - this remains a Significant audit risk	<p>In addition to a focused review of manual accruals our work will include a suite of mandatory procedures performed regardless of specifically identified fraud risks, including:</p> <ul style="list-style-type: none"> <li>▶ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;</li> <li>▶ Assessing accounting estimates for evidence of management bias; and</li> <li>▶ Evaluating the business rationale for significant unusual transactions.</li> </ul> <p>Our testing of expenditure transactions at interim audit identified two items of 2018-19 under-accrued costs. We have requested additional information around these items and will evaluate the impact for 2019-20 testing as part of our preparation for the final audit visit.</p>
Incorrect accounting for income from investment and leasehold properties - risk of fraud in revenue and expenditure recognition	Significant	No change - this remains a Significant audit risk	<p>At final audit we will review a sample of investment property and leasehold property income to confirm it is appropriately accounted for, particularly around the year end, given this is the first year of allocating income streams to correct accounting periods for Croxley Park and could be more prone to fraud or error.</p>
Accounting for the Acquisition of Croxley Business Park	Significant	No change - this remains a Significant audit risk	<p>EY accounting specialists have worked closely with the Authority to review accounting treatment for the Business Park. At the time of writing this report, we were awaiting further documentation in key areas to conclude. Once the accounting treatment has been agreed, we anticipate engaging with valuation specialist colleagues to review the data, methodology and assumptions supporting final valuation. We aim to complete this process before the start of our final audit in September.</p>

## Update on audit risks

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### Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from 19/20 audit plan	Details
Valuation of Land and buildings	High Inherent	No change - this remains an inherent audit risk	<p>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. RICS has explained this is not a 'disclaimer' in the valuation: valuers are continuing to apply their professional judgement, this is disclosing the additional uncertainty attached to current valuations. This is particularly relevant for Fair Value / Market Value based assets because of the paucity of market information available at 31 March upon which to give those valuations.</p> <p>We will need to discuss with management what disclosures they will be including in the financial statements and the impact on the audit approach as currently outlined in the audit plan.</p> <p>Depending on materiality of Land and Buildings, we may consult with auditor valuation specialists.</p>
Going Concern and Covid-19	High inherent	New risk - whilst going concern and compliance with ISA570 had always been an area of interest, the increased uncertainty and requirement for new disclosures is new	<p>There is presumption that the Council will continue as a going concern. However, the current and future uncertainty over government funding and other sources of Council revenue as a result of Covid-19 emphasises the need for the Council to undertake a detailed going concern assessment to support its assertion. From an audit perspective, the auditor's report going concern concept is a 12-month outlook from the audit opinion date, rather than the balance sheet date. So, this year, for example, we will need to see evidence of going concern up to and including 12 months from the date of signing. This will need information relevant to the 2021/22 financial year. We will be scrutinising the Council's revised financial plans and cashflow, liquidity forecasts, known outcomes, sensitivities, mitigating actions and key assumptions. We will also discuss with management the need to make specific disclosures in the 2019/20 statements in relation to IAS 1 and IAS 10 covering both going concern, in particular any material uncertainties, and events after the balance sheet date.</p>

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### Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from 19/20 audit plan	Details
Valuation of Pension Fund Assets and Liabilities	High Inherent	No change - this remains an inherent audit risk	<p>Pension Fund Assets and Liabilities are high risk estimates. To test them we will:</p> <ul style="list-style-type: none"> <li>▶ <b>Liaise</b> 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 - we will focus on how Covid-19 uncertainty is reflected in the Pension Fund audit Report;</li> <li>▶ Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used;</li> <li>▶ Review and test the accounting entries and disclosures made within Watford Borough Council's financial statements in relation to IAS19; and</li> <li>▶ Be mindful of that fact that volatility in the financial markets is likely to have a significant impact on pension assets, and therefore net liabilities.</li> </ul>
Valuation of NNDR Appeals Provision	High inherent	No change - this remains an inherent audit risk	<p>The NNDR Appeals Provision is a high risk estimate. To test it we will:</p> <ul style="list-style-type: none"> <li>▶ Consider the work performed by Inform, including the scope of the work, data provided to Inform and assumptions used; and</li> <li>▶ Compare the level of appeals at 31 March 2019 and 31 March 2019 to assess the reasonableness of amounts provided for at year end.</li> </ul>
IFRS16 - leases	No longer an area of focus for 2019-20	Removed as an area of focus	<p>The implementation of IFRS16 into the Code of Audit Practice has been delayed until 2020-21. This is no longer an area of focus for 2019-20.</p>

## Update on audit risks

The following 'dashboard' summarises audit risks and areas of focus and the significant accounting and auditing matters identified as a result of Covid-19. It seeks to provide the Audit Committee with an overview of any changes in risks identified in the current year.

### Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from plan	Details
Value for money - managing cash receipts from Leasehold and Investment Properties	Significant risk	New risk	<p>In 2018-19, we undertook testing to determine whether the decision to acquire a leasehold interest in Croxley Business Park involved taking informed decisions and deploying resources in a sustainable manner.</p> <p>We were able to conclude that appropriate scrutiny had been applied by Cabinet and Full Council to the decision making process but noted the associated revenue management impact would be considered as part of our value for money work for 2019/20.</p> <p>With the impact of Covid-19 having so markedly now changed the economic landscape, the effectiveness of revenue management will be even more critical to sustainable resource deployment.</p>

## Update on audit risks

### Other areas of audit focus as a result of Covid-19

- ▶ **Revenue recognition** - there may be an impact on income collection (Council and Business rates) if businesses and residents are unable to work and earn income due to the lockdown and restriction of movement due to Covid-19.
- ▶ **Holiday and sickness pay** - the change in working patterns may result in year-end staff pay accruals which are noticeably different to prior years.
- ▶ **Annual Governance Statement** - the widespread use of home working is likely to have changed the way internal controls operate. The Annual Governance Statement will need to capture how the control environment has changed during the period and what steps were taken to maintain a robust control environment during the disruption. This will also need to be considered in the context of internal audit's ability to issue their Head of Internal Audit opinion for the year, depending on the ability to have completed the remainder of the internal audit programme.

### Impact on audit delivery

- ▶ **Remote working** - Our audit documentation tool, Canvas, and the EY Client Portal enable us to undertake the majority of our audit procedures by working remotely. To date, the Council's finance team have also been able to deal with audit queries remotely.
- ▶ **Audit evidence** - Whilst remote working is operating relatively effectively, there are likely to be some aspects of audit evidence where we will need to work collaboratively with the finance team to ensure its appropriateness and sufficiency. For example, typically we would sit down with the finance team to observe them running reports from the ledger which support balances in the statements. We will need to agree a practical and effective way that we can gain the same assurance but working remotely. There may be additional challenges related to validating existence of tangible assets. Our approach to address existence would include physical inspection of assets. However, in current circumstances, we would need to agree effective way with management to gain same assurance. Dealing pragmatically with these challenges may increase the duration of the year end audit.
- ▶ **Timing** - As a result of the pandemic, MHCLG have changed the financial reporting dates for local authorities. Councils are now required to publish draft statements by the 31 August (from 31 May) and publish audited accounts (or state where they have not been audited) by 30 November (from 31 July). Our final audit visit is scheduled to start in September 2020, with a view to submitting our Audit Results Report to the Audit Committee meeting scheduled to take place on 25<sup>th</sup> November 2020.
- ▶ **Fees** - As shown in the Appendix to this report, the scale fee agreed with PSAA for our work was £40,021. Variations are expected in connected with the need to engage accounting and potentially real estate specialists for our work on Croxley Park; additional work to address the consequences of Covid-19 and potential delays arising from those consequences; and our planned work to address the VFM risk around managing investment property revenue.



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## Appendices



## Appendix - Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government.

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.

At the time of writing this report, the extent of planned 2019/20 HB work was still under consideration.

	Planned fee 2019/20	Scale fee 2019/20	Final Fee 2018/19
	£	£	£
Total Fee - Code work	40,021	40,021	40,020
Other	TBC		3,999
<b>Total audit</b>	<b>TBC</b>	<b>40,021</b>	<b>44,019</b>
Other non-audit services not covered above (Housing Benefits)	TBC		19,000
<b>Total other non-audit services</b>	<b>TBC</b>		<b>19,000</b>
<b>Total fees</b>	<b>TBC</b>		<b>63,019</b>

### **All fees exclude VAT**

At the time of writing this report, the extent of planned 2019/20 HB work was still under consideration.

For the 2019/20 financial statements audit, the scale fee will be impacted by a range of factors which will result in additional work. An estimate of the potential additional fee for this will be provided during the final audit process.

### **Additional factors include:**

- the need to engage accounting and potentially real estate specialists for our work on Croxley Park;
- additional work in connection with Covid-19; and
- work to address the VFM risk around managing investment property revenue.

In addition, we are driving greater innovation in the audit through the use of technology. The significant investment costs in this global technology continue to rise as we seek to provide enhanced assurance and insight in the audit.

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.