Report to the Standards and Audit Committee

WOKING BOROUGH COUNCIL

Audit Progress Report: year ended 31 March 2020

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WELCOME

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We have pleasure in presenting our Audit Progress Report to the Standards and Audit Committee. This report is an integral part of our communication strategy with you, a strategy which is designed to ensure effective two way communication throughout the audit process with those charged with governance.

It summarises the results of the work to date for the year ended 31 March 2020, specific audit findings and areas requiring further discussion and/or the attention of management or the Standards and Audit Committee.

At the conclusion of our audit we will issue an Audit Completion Report to the Audit and Standards Committee. This will set out the results of our audit of the financial statements and use of resources comprising: audit work on key risk areas, including significant estimates and judgements made by management, critical accounting policies, any significant deficiencies in internal controls, and the presentation and disclosure in the financial statements.

In the meantime if you would like to discuss any aspects in advance of the meeting we would be happy to do so.

We would also like to take this opportunity to thank the management and staff of the Council for the co-operation and assistance provided to date.

Steve Bladen

3 March 2022

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements and use of resources. This report has been prepared solely for the use of the Standards and Audit Committee and Those Charged with Governance and should not be shown to any other person without our express permission in writing. In preparing this report we do not accept or assume responsibility for any other purpose or to any other person. For more information on our respective responsibilities please see the appendices.

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Overview

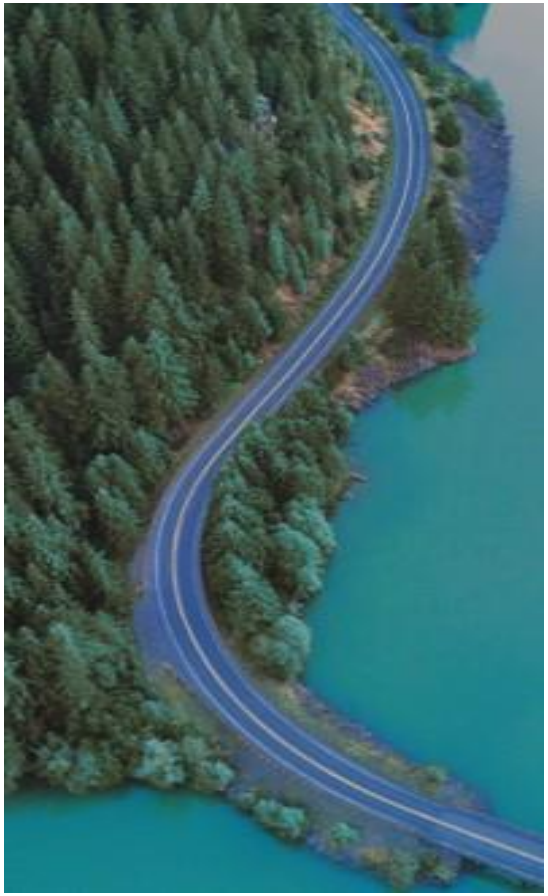
Our audit work is currently in progress. The matters set out in this report provide an overview of the matters identified from our audit work to date, and are the matters we believe are important to the Standards and Audit Committee in reviewing the results of our audit of the financial statements and use of resources of the Council for the year ended 31 March 2020.

The report is also intended to promote effective communication and discussion and to ensure that the findings emerging from our audit appropriately incorporate input from those charged with governance.

We have set out the outstanding matters on pages 40 and 41 of our report.

To date there have been no significant changes to the planned audit approach and no additional significant audit risks have been identified other than those risks reported to you in our Audit Planning Report dated 4 March 2021.

No restrictions have been placed on the audit work completed to date.



THE NUMBERS

Executive summary

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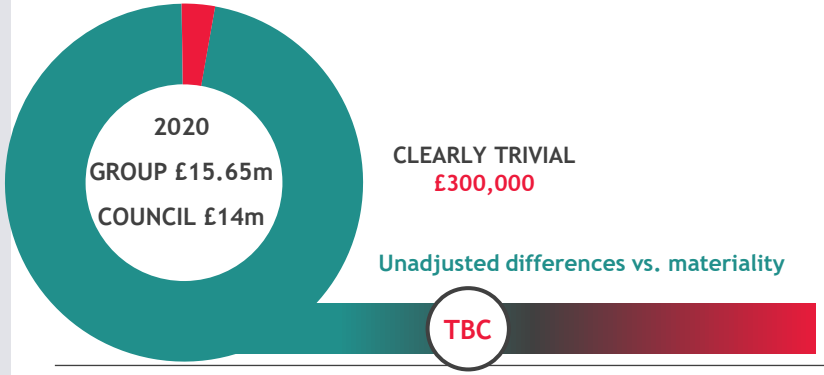
Final materiality

Final Group financial statements materiality was determined based on 1% of the value of gross assets on the balance sheet. Specific materiality on the Comprehensive Income and Expenditure Statement was based on 2% of income.

Based on the draft financial statements we calculated our final materiality as:

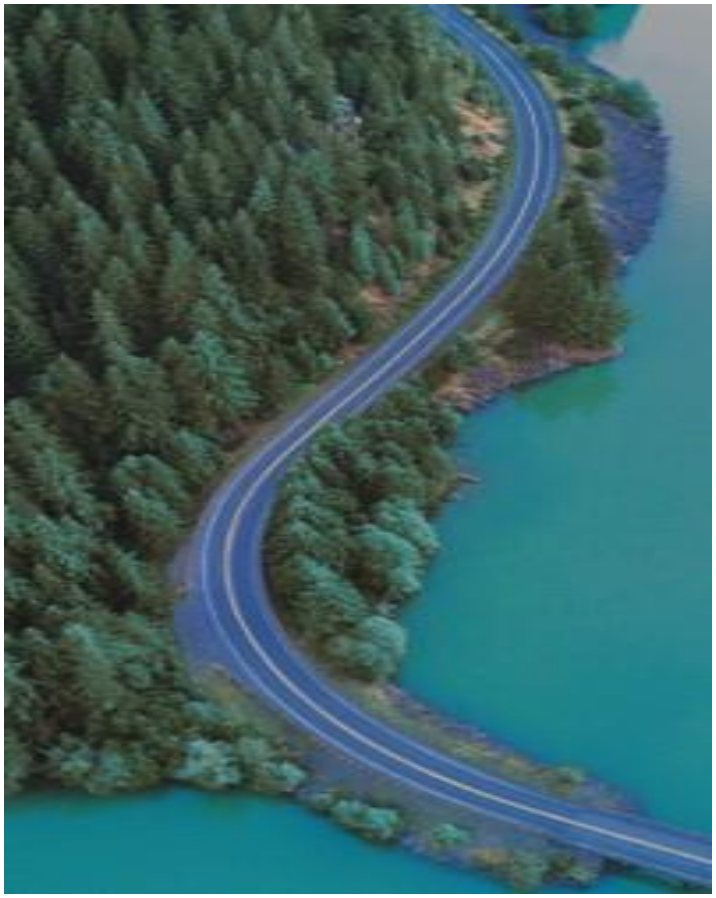
- Group Materiality £15.65 million based on gross assets of £1.565 billion (Council £15.5 million)
- Specific CIES Group Materiality £2.6 million based on gross income of £130 million (Council £2.5 million).

We set our reporting level for clearly trivial misstatements at 2% of our materiality level.



Misstatements

In this report we have referred to a small number of misstatements which we are in the process of discussing with management. Upon resolution and conclusion of these issues we will prepare an audit completion report that sets out the impact of these on the surplus/deficit on the provision of services for the year.



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Financial reporting

Based on the audit work that we have completed to date, and subject to resolution of the outstanding matters identified, in this report:

- We have not identified any non-compliance with accounting policies or the applicable accounting framework.
- No significant accounting policy changes have been identified impacting the current year.
- Disclosures relating to going concern are sufficient

Other matters that require discussion or confirmation

- Confirmation on fraud, contingent liabilities and subsequent events.

Independence

We confirm that the firm and its partners and staff involved in the audit remain independent of the Council in accordance with the Financial Reporting Council's (FRC's) Ethical Standard.

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Work substantially completed

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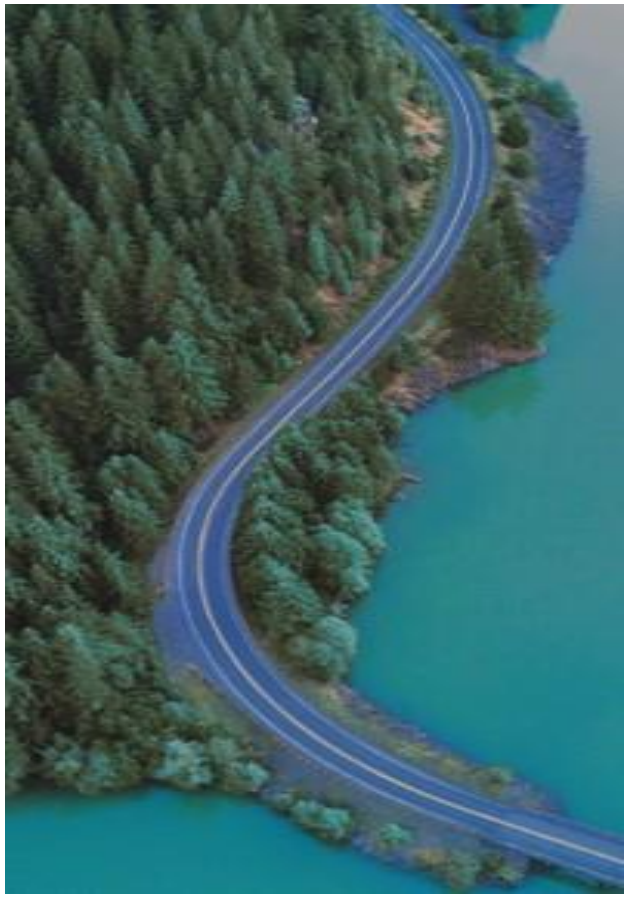
Work substantially completed

Our work is in progress across the file, however we have substantially completed a lot of our testing, including in the following areas:

- Investments
- Accrued interest on receivables and interest income received
- Sample testing of credit notes
- Borrowings (except two outstanding requests which have been noted on page 37)
- Grant receipts in advance
- VAT review
- Pensions liability
- Cut off testing across income and expenditure
- Recharges and overheads
- Grant Income received
- Testing on a sample of other income and expenditure items not tested elsewhere
- Journals
- Related party transactions
- Asset existence
- Depreciation
- Assets transferred
- Operating leases
- Asset disclosure notes
- Asset disposals
- Assets under construction
- Expenditure completeness
- Interest payments
- Housing benefits expenditure
- Payroll
- Housing Revenue Account (including income and expenditure testing, system reconciliations, disclosures in the accounts)
- Cash flows statement
- Review of minutes



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AUDIT RISKS OVERVIEW

As identified in our Audit Planning Report dated 4 March 2021 we assessed the following matters as being the most significant risks of material misstatement in the financial statements. These include those risks which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit and the direction of the efforts of the engagement team.

Audit Risk	Risk Rating	Significant management estimate or judgement	Use of experts required	Error identified	Significant control findings
Management override of controls	Significant	No	No	No	No
Revenue and expenditure recognition	Significant	No	No	No	No
Property, plant & equipment and investment property valuation	Significant	Yes	Yes	TBC	TBC
Pension liability valuation	Significant	Yes	Yes	Yes	No
Allowance for non-collection of receivables	Significant	No	No	TBC	TBC
Group consolidation	Significant	No	No	TBC	TBC
Recoverability of loans to subsidiaries and associate	Significant	Yes	No	No	No
Minimum Revenue Provision (MRP) policy	Significant	No	No	TBC	TBC
Going concern	Normal	No	No	No	No
Sustainable finances (use of resources)	Significant	Yes	No	No	No
Decision making with respect to the football club development (use of resources)	Significant	No	No	TBC	TBC

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MANAGEMENT OVERRIDE OF CONTROLS

Risk description

The auditor's responsibilities relating to fraud in an audit of financial statements requires us to presume that the risk of management override of controls is present and significant in all entities.

Auditing standards presume that management is in a unique position to perpetrate fraud by overriding controls.

Significant risk	■
Normal risk	
Significant management estimate or judgement	
Use of experts	
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	

Work performed

To address this risk we undertook the following audit procedures:

- Analysed and verified journal entries made in the year, agreeing the journals to supporting documentation. We determined key risk characteristics to filter the population of journals. We used our IT team to assist with the journal extraction;
- Assessed estimates and judgements applied by management in the financial statements to assess their appropriateness and the existence of any systematic bias; and
- Reviewed unadjusted audit differences for indications of bias or deliberate misstatement.

Results

Our audit work on journals did not identify any issues.

Based on the work we have completed to date:

- Our review of management estimates has not identified the existence of any systemic bias. Further commentary on significant management estimates are included on the following pages.
- We have not identified any evidence to suggest that unadjusted audit differences are indicative of bias or deliberate misstatement by management.

Conclusion

Based on the work we have completed to date, we have no matters to bring to your attention. We will report our final conclusion on this risk in our Audit Completion Report.

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REVENUE AND EXPENDITURE RECOGNITION

Risk description

Under auditing standards there is a presumption that income recognition presents a fraud risk. For the Council, we consider the risk of fraudulent revenue recognition to be in respect of the accuracy and existence of investment property income and non-ringfenced grant income.

In the public sector the risk of fraud in revenue recognition is modified by Practice Note 10 issued by the Financial Reporting Council. This states that auditors should also consider the risk that material misstatements may occur through the manipulation of expenditure recognition. This risk is identified as being relevant to the cut-off of expenditure, where our testing will be focussed.

Under auditing standards there is a presumption that income recognition presents a fraud risk.

Significant risk	■
Normal risk	
Significant management estimate or judgement	
Use of experts	
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	

Work performed

To address this risk we undertook the following audit procedures:

- Tested an increased sample of grants included in income to documentation from grant paying bodies and checking whether recognition criteria have been met;
- Tested an increased sample of investment property income to supporting documentation, including lease agreements, contracts and rent reviews; and
- Tested a sample of expenditure either side of year end, to confirm that expenditure has been recorded in the correct period and that all expenditure that should have been recorded at year-end has been.

Results

Work completed

Our testing of grants confirmed that these were recognised when performance conditions attached to them had been satisfied.

Our sample testing of investment property income did not identify any errors in the recognition of income.

Work ongoing

Our expenditure cut off testing identified a small number of instances where transactions were recognised in an incorrect year. This has resulted in an error of £0.450 million being identified. Our work is ongoing on this area to establish the extent of the factual error and any projected error. We will report in our final audit completion report the result of our testing and the total error identified.

Conclusion

Based on the work we have completed to date, we have no matters to bring to your attention. We will report our final conclusion on this risk in our Audit Completion Report.

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PROPERTY, PLANT & EQUIPMENT AND INVESTMENT PROPERTY VALUATIONS

Risk description

Local authorities are required to ensure that the carrying value of land, buildings and dwellings is not materially different to the current value (operational assets) or fair value (surplus assets, assets held for sale and investment properties) at the balance sheet date. The Council's valuers are engaged to provide valuations at 31 January 2020, and to refresh these valuations to 31 March 2020. We consider there to be a risk over the valuation of these assets owing tio the estimation uncertainty, and where updated valuations have not been provided for a class of assets at the year-end.

The valuation of non-current assets is a significant risk as it involves a high degree of estimation uncertainty.

Significant risk	■
Normal risk	
Significant management estimate or judgement	■
Use of experts	■
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	■

Work completed

We have completed the following audit procedures:

- Reviewed the instructions provided to the valuer and reviewed the valuer's skills and expertise in order to determine if we can rely on them as a management expert;
- Confirmed that the basis of valuation for assets valued in year is appropriate based on their usage;
- Reviewed the accuracy and the completeness of asset information provided to the valuer;
- Reviewed assumptions used by the valuer in light of prevailing market conditions to support the valuations, including any material uncertainty for classes of assets;

Work ongoing

Work on the following areas remains ongoing

- We continue to undertake further work on valuation movements that appear unusual or outside of our expectations
- We continue to engage with our own expert to assess the assumptions made by management in determing the value of each asset; and
- Reviewing the work undertaken by the subsidiary auditor on significant asset valuations.

Results

Our review of instructions to the valuer and our assessment of the valuer's skills and expertise did not identify any issues. We confirmed the basis of valuation for assets valued in year is appropriate and in line with Code.

The results of our review of the assumptions and estimates used by the valuer for each class of assets is set out on the following pages.

Our review of the information provided to the valuer by the Council has not identified any issues.

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Council dwellings at Open Market Value Social Housing (valuation at 31 March 2020: £285 million)

Council dwellings are valued at open market value, then adjusted to 33% of this valuation to reflect the discounted social rents charged to tenants. The adjustment reflects information provided by DCLG in 2016 for regional differences between market rents and social rents. The Housing Stock was revalued as at 1 April 2020 as a proxy for 31 March 2020. The revaluation was prepared by a Senior Estates Officer within the Council, with Beacon properties being valued by Frazers Chartered Surveyors.

Based on the vacant possession value of these assets, after adjusting for additions and reductions in year, there was a reduction in the value of these assets of 3.16 million. This decrease is inconsistent with other indexes, which tend to show small increase in property values. We continue to undertake further work to understand the reasons for this discrepancy. We will update our findings in relation to this class of asset in our Audit Completion Report.

< lower | Impact of assumptions on the estimate/judgement | higher >

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Other Land and Buildings valued at Depreciated Replacement Cost (valuation at 31 March 2020: £54 million)

Leisure centres are valued at depreciated replacement cost using the existing gross internal area and estimated rebuild costs. This valuation is then reduced to reflect the age and remaining useful economic life of the building. In relation to this class of asst, the following work is in progress:

- Confirmation of the cost per sq/m and location factor used to the BCIS database.
- For a sample of material assets we are in the process of obtaining the input data provided to the valuer
- We will test the assumptions made by the valuer with our own internal expert

Based on the work we have completed to date, we have no matters to bring to your attention. We will report our final conclusion on this risk in our Audit Completion Report.

< lower | Impact of assumptions on the estimate/judgement | higher >

Other Land and Buildings at Existing Use Value (valuation at 31 March 2020: £110 million)

Other land and buildings valued at existing use current value have been revalued upwards by a net £12.8 million (+13). The variances observed is largely as a result of a net upwards movement across various car parks (£16.8 million) offset by a reduction in value of £4 million on the Lightbox museum. In relation to this class of asset, the following work is in progress:

- We have sought an explanation from management and the valuer regarding the reduction in value of the Lightbox Museum, and our work on this area is ongoing. We have initially queried the movement with management and the valuer. The reduction is due to the property being subject to a 125 year ground lease.
- We are also querying the upward revaluation on the Peacocks Car Park. There was an impairment in the prior year of £862k however, a £1.8 million gain has been recognised in the current year.

Based on the work we have completed to date, we have no matters to bring to your attention. We will report our final conclusion on this risk in our Audit Completion Report.

•< lower | Impact of assumptions on the estimate/judgement | higher >

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Investment properties valued at fair value (Group valuation at 31 March 2020: £576 million)

Investment properties measured at fair value owned directly by the Council are valued at £362 million and the Group financial statements include a further £214 million investment properties at 31 March 2020, mainly comprising housing units.

Investment properties are valued at fair value (highest and best use) usually based on the current and future potential rent yields.

Investment properties have seen an overall decrease in valuation of £19.8 million in year. The main drivers to this reduction in valuation arise from reduction in the valuation of the Wolsey Place shopping centre (£5.8 million), Dukes Court (£5 million), Victoria Gate (£2.3 million), Midas House (£2.1 million) and Kestral Way units (£2.8 million).

We have completed the following work to date:

- For all material investment property revaluations we reviewed the input data provided to the actuary and assessed this against the valuation report to confirm accuracy.

The following work remains in progress:

- Our review of the work undertaken by component auditor on investment property held by the Council's wholly owned subsidiaries.
- Testing the assumptions used in the valuation of these assets with our own expert.

< lower | Impact of assumptions on the estimate/judgement | higher >

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PENSION LIABILITY VALUATION

Risk description

The valuation of the defined benefit obligation is a complex calculation involving a number of significant judgements and assumptions. The actuarial estimate of the pension fund liability uses information on current, deferred and retired member data and applies various actuarial assumptions over pension increases, salary increases, mortality, commutation take up and discount rates to calculate the net present value of the liability.

The valuation of the pension liability is a significant risk as it involves a high degree of estimation uncertainty.

Significant risk	■
Normal risk	
Significant management estimate or judgement	■
Use of experts	■
Unadjusted error	■
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	■

There is a risk that the membership data submitted in the 2019 triennial valuation by the administrating authority (Surrey County Council) and 2019/20 cash flows provided to the actuary at year end may not be accurate, and that the actuary uses inappropriate assumptions to value the liability. Relatively small adjustments to assumptions used can have a material impact on the Council's share of the scheme liability.

Actuaries have been asked to include the estimated liability for the McCloud judgement in the accounting valuation based on assumptions in the revised pension liability calculations used in the previous year. The process for agreeing and legislating for the changes required to scheme benefits is likely to take some time.

Work performed

We carried out the following planned audit procedures:

- Agreed the disclosures in accounts to information provided by the actuary
- Reviewed the competence of the management expert (actuary);
- Reviewed the controls in place for providing accurate membership data to the actuary and testing the data provided at the triennial valuation through our audit of the pension fund;
- Checked that any significant changes in membership data since the triennial submission have been communicated to the actuary;
- Contacted the pension fund auditor and requested confirmation of the controls in place for providing accurate
- Assessed how the actuary has addressed recent discrimination cases in the liability calculation;
- Reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data; and
- Discussed with management steps taken to assess the impact of the volatility in global stock markets on the Council's pension fund liability.

Results

Our review of the competence of the actuary did not identify any issues. Our review of the pension highlighted one change that needed to made to the disclosure notes (incorrect figure use for unfunded liabilities in Pensions explanatory notes).

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The valuation of the pension liability is a significant risk as it involves a high degree of estimation uncertainty

Results (continued)

The Pension fund auditor confirmed that the pension fund performed a data cleanse activity ahead of the valuation cycle, which included pensioner/deferred member existence testing and member tracing. The exercise allowed for identification of any addresses not matched on the current system, and ensured that deferred members are marked as having left.

Management confirmed that there are no significant changes in membership and this is consistent with our knowledge of the Council.

We identified that the actuary estimated a loss on investment of 10.7% compared to an actual loss of 11%, resulting in an overstatement of the Council's share of the scheme's assets by £0.877 million, and understatement of the net pension liability by £0.877 million.

The following discrimination cases covering GMP gender equality, McCloud age discrimination and Goodwin spousal pensions are currently subject to remedy action that is likely to impact on liability to pay future pensions.

GMP

The actuary has applied full GMP indexation for members at state pension age. This is consistent with all other local government actuaries. In the prior year the actuary included an allowance of £0.359 million in the past service cost for GMP. No further updates have been made in 2019/20 to the allowance recognised in 2018/19.

McCloud

The Government's consultation document suggests that members in the scheme at 2012 will qualify for the scheme amendments. Based on a review of actuaries IAS19 reports undertaken by PwC, we note that the liability calculated by Hymans was estimated to cover members who joined the scheme after 2012 suggesting Hyman's was quite prudent on what remediation might cover and included members who joined after 2012. In the prior year the actuary estimated the impact of McCloud to be £0.245 million and included this as past service cost in the accounts. The actuary noted that they have again included an estimate for the McCloud judgement allowance in the formal liabilities valuation so the impact continues to be included within the balance sheet at 31 March 2020 (as per the 2019 accounting approach).

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The valuation of the pension liability is a significant risk as it involves a high degree of estimation uncertainty

Results (continued)

Goodwin

In July 2020, HM Treasury announced that it would be amending the Teachers' Pension scheme to remove the differential in survivor pensions for same sex marriage or civil partnerships following the Goodwin case, and that this will also apply to other public sector pension schemes. The actuary confirmed no allowance was made for the impact of the Goodwin case however based on their high level analysis of LGPS, the Goodwin judgement only affects a small proportion of scheme members, with an average impact of 0.1% of liabilities. Based on this we have estimated pension liability to be understated by £0.682 million for the Council.

The results of our review of the reasonableness of the assumptions used in the calculation against other local government actuaries and observable data is reported on the following page.

Conclusion

The defined benefit obligation has been appropriately calculated and the assumptions used are reasonable, although the net liability had not been updated to reflect the impact of actual return on assets and no additional liability has been included following the Goodwin legal case.

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PENSION LIABILITY VALUATION 4

Significant estimate – LGPS pension liabilities

Council pension liabilities £159.254 million funded LGPS and £4.597 million unfunded promised retirement benefits

< lower **Impact of assumptions on the estimate** **higher >**

The Council's pension liability has decreased from £177.229 million to £163.851 million and it's share of the scheme assets decreased from £106.482 million to £95.646 million. The net deficit decreased by £2.542 million to £68.205 million. The reduction in the liability includes £12.373 million savings from changes to financial assumptions such as reduced annual pension increases at 1.9% (previously 2.5%) offset by a fall in the rate of discounting scheme liabilities to 2.3% (previously 2.4%); £3.989 million savings from demographic assumptions and reduced longevity of members; and £1.602 million reduction from updates to membership information from the 2019 triennial update. The share of scheme assets has reduced by £10.836 million due to falling investment values in the pension fund.

The key estimates are the following financial and mortality assumptions. We have compared the key financial and demographic assumptions used to an acceptable range provided by our a consulting actuary.

	Actual used	Acceptable range	Comments
Financials:			
- RPI increase	2.90%	2.7 - 2.90%	Reasonable
- CPI / pensions	1.90%	1.8 - 2.00%	Reasonable
- Salary increase	2.80%	1.8 – 2.90%	Reasonable - short term assumption of lower rate and increasing long term assumption
- Discount rate	2.30%	2.30%	Reasonable
Commutation:			
- Pre 2008	25%	25% to 75%	Reasonable
- Post 2008	63%	25% to 75%	Reasonable
Mortality:			
- Male current	22.1 years	20.5 – 22.2	Reasonable
- Female current	24.3 years	22.9 – 24.3	Reasonable
- Male retired	22.9 years	21.6 – 23.3	Reasonable
- Female retired	25.7 years	24.6 - 26.3	Reasonable
Mortality gains	CMI 2018 (+1.25% improvement rate) with Club Vita local adjustments		Reasonable

We consider that the assumptions and methodology used by the Council's actuary are appropriate, and will result in an estimate of the pension liability which falls within a reasonable range. Our actuary has provided an estimate of the overall strength of assumptions and this indicates that the estimate has tended towards a slightly prudent (higher) liability mainly due to using the CMI 2018 mortality gains rather than the latest available CMI 2019 tables.

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ALLOWANCE FOR NON COLLECTION OF RECEIVABLES

Risk description

The Council recognises an allowance for the non-collection of receivables (arrears and debt), primarily in respect of council tax, Non-domestic rates (NDR) housing benefit overpayments, housing rents, commercial rents and parking penalty charge notices. The Council assesses each type of receivable separately in determining how much to allow for non-collection.

There is a risk over the valuation of this allowance if incorrect assumptions or source data are used, or an inappropriate methodology is applied.

There is a risk over the valuation of the allowance for the non-collection of receivables.

Significant risk	■
Normal risk	
Significant management estimate or judgement	
Use of experts	
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	■

Work performed

We carried out the following planned audit procedures:

- Reviewed the provision model for receivables and debt balances to assess whether it appropriately reflects potential default losses in light of current conditions using historical collection rates, an assessment of potential defaults for customers making use of deferral arrangements and aging of debt, and future losses and assessing the sensitivities to the impairment calculation and assumptions used by management.

Our audit work to address this significant risk is still in progress. We have set out on the following pages the results of the work completed to date for each class of debtor.

Conclusion

Based on the work we have completed to date, we have no matters to bring to your attention. We will report our final conclusion on this risk in our Audit Completion Report.

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ALLOWANCE FOR NON COLLECTION OF RECEIVABLES

Significant estimate – allowance for credit losses

Gross receivables £38.654 million and total credit loss allowance £3.784 million

< lower | Impact of assumptions on the estimate | higher >

Council tax arrears

The Council has recognised an allowance for non-collection in relation to its share of the council tax arrears of £293,000 against its share of the arrears of £729,000 (total council tax arrears was £3.455 million). The Council's provision increased by £151,000 on the prior year. The provision is estimated using historic collection rate information and CIPFA recommended percentages to be applied to debt of a certain age.

Non-Domestic Rate arrears

The Council has recognised an allowance for non-collection in relation to its share of the NDR business rates arrears of £529,000 against its share of the arrears of £681,000 (total NDR arrears was £1.703 million). The Council's provision had increased substantially from the prior year, up £258,000. The provision is estimated using historic collection rate information and CIPFA recommended percentages to be applied to debt of a certain age. An extra provision due to the Covid-19 pandemic was recognised. This was double the initial allowance recognised causing the large increase on the prior year.

Rent deposits

The Council has recognised an allowance for non-collection of Rent Deposit Scheme debt of £441,000 on total debt of £491,000. The Council's provision has decreased by £10,000 from the prior year. The provision is estimated using historic collection rate information and the judgement of key finance personnel. The Council has assess the risk of default as high, hence the size of the allowance against the total debt balance.

Housing benefits overpayments

The Council has recognised an allowance for non-collection of housing benefits overpayment debt of £1.162 million against a total debt of £2.083 million. This has increased by £98,000 from the prior year. The provision is estimated using historic collection rate information and CIPFA recommended percentages to be applied to debt of a certain age.

Rents arrears

The Council has recognised an allowance for non-collection of housing rents arrears of £493,000 on total debt of £874,000. This has increased by £175,000 from the prior year. The provision is estimated using actual year end account arrears figures, with a judgemental recovery scale provided based upon historical recovery information. Our work on this remains in progress, in particular we continue to assess the impact of the Council applying historical default rates (incurred losses) to determine the credit loss rather than expected (future) credit losses. However, we do not consider this likely to result in a material difference in the amount of credit losses recognised.

Other sundry debtors

The Council has recognised an allowance for non-collection of sundry debt arrears of £618,000 on total debt of £6.047 million. This has increased by £236,000 from the prior year. The provision is estimated using the year end aged debtor report and the judgement of management to inform the debt level to consider. Our work on this remains in progress, in particular we continue to assess the extent to which the Council has assessed expected (future) credit losses to determine the provision.

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GROUP CONSOLIDATION

Risk detail

The Group financial statements include a large number of subsidiary entities with intra-group transactions and balances to be eliminated. There is a risk that due to the complexity and number of subsidiaries that there may be errors in the consolidation process and/or failure to eliminate intra-group transactions and balances.

The subsidiary entities also produce audited accounts to 31 December 2019 and there is a risk that material transactions for the remaining 3 months up to the Group year end at 31 March 2020 (and the previous year) may not be reported or valuations may be materially different.

There is a risk that due to the complexity and number of subsidiaries that there may be errors in the consolidation process and/or failure to eliminate intra-group transactions and balances.

Significant risk	■
Normal risk	
Significant management estimate or judgement	
Use of experts	
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	

The subsidiary entities prepare financial statements under UK GAAP (FRS 102) rather than IFRSs and transactions and balances may require adjustment in the Group financial statements where accounting policies differ under IFRS based reporting standards.

Progress to date

We received the Council's group accounts along with the detailed consolidation working papers in January 2022. Our work on this risk is therefore ongoing. We have completed the following work to date:

- Agreed the component entities' group consolidation returns to the audited accounts;
- Confirmed if any subsequent adjustments reflected in the returns for material transactions and valuation updated to 31 March 2020 to underlying transactions and valuation certificates;
- Agreed the adjustments required for any material accounting policy differences from UK GAAP and IFRS;

The following work remains ongoing:

- Agreeing the consolidation process and intra-group elimination of transactions and balances.
- Review of work undertaken by the component auditor in relation to subsidiary entities.

Conclusion

Based on the work we have completed to date, we have no matters to bring to your attention. We will report our final conclusion on this risk in our Audit Completion Report.

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RECOVERABILITY OF LOANS TO SUBSIDIARIES AND ASSOCIATE

Risk detail

The Council provides loan funding to its subsidiaries and Victoria Square to fund their capital spending and this has increased significantly in recent years. The balance at 31 March 2020 stood was £732 million (31 March 2019: £497 million).

COVID-19 has impacted on many businesses and where the business model requires these entities to generate sufficient profits to repay this debt there is a risk that the impact on profits may result in some debt not being repaid.

There is a risk that loans advanced to subsidiaries and associate entities are not entirely recoverable according to the latest business plans.

Significant risk	■
Normal risk	
Significant management estimate or judgement	
Use of experts	
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	
Letter of representation point	

Work ongoing

- Review of the business plans for the major Thameswey group subsidiaries to receive significant loan finance and understand when repayments are proposed and the percentage of loan recoverable; and
- Assess whether there are any impairment indicators that need to be taken into consideration for the balance sheet reporting date and whether this will impact the valuation at year end.

Results

The Council has provided a loan to Victoria Square Ltd, with the balance standing at £356 million as at 31 March 2020. This amount increases to £567 million as at 31 March 2021, with further commitments of £107 million recognised at 31 March 2021. This reflects the cost pressures and project delays, in part due to Covid-19.

Our work in relation to this significant risk is currently ongoing, and will draw on our review of the work undertaken by the auditor of the Council's wholly owned subsidiary's, and our review of the business plan and projections for significant subsidiary's.

Conclusion

Our work is ongoing on the recoverability of loans to subsidiaries and associate, and we will conclude on the risk in our final audit completion report

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MINIMUM REVENUE PROVISION (MRP) POLICY

Risk detail

In the prior year we raised the issue that the MRP policy does not set aside any charge against the borrowing obtained to fund the loans to subsidiaries and the Victoria Square Ltd associate. The Council's MRP strategy notes that the Council's borrowing is repaid on a back-to-back basis against loan repayments from these entities and that the business models would result in full repayment of the loans over the next 50 years.

The Government and CIPFA have become concerned that local authorities are not putting aside sufficient resources to repay loans and MHCLG issued amended regulations for calculating a 'prudent' MRP charge for any new borrowing and investments from 1 April 2019. This is likely to increase the annual MRP charge for local authorities. While the regulations allow previous MRP policies to continue for historic borrowing, Government has advised that local authorities should revisit their existing MRP policies against the new guidance, particularly for investments where no MRP is currently being charged. Under the revised guidance a higher MRP would have been charged on some historic borrowing.

There is a risk that the current MRP policy is not sufficiently prudent and does not comply with revised DLUHC guidance

We recommended that the Council reviews its existing MRP policy to confirm that it is compliant with the new guidance for investments supported by borrowing from 1 April 2019. We also recommended that for pre-April 2019 investments, that the Council closely monitor the business plans of the subsidiaries to confirm that the loans will be fully repaid. If it considered the loans will not be repaid it would be appropriate to commence making an MRP charge against that borrowing.

Significant risk	■
Normal risk	
Significant management estimate or judgement	
Use of experts	
Unadjusted error	
Adjusted error	
Additional disclosure required	
Significant control findings to be reported	■
Letter of representation point	

Work ongoing

To address this significant risk we have requested that the Council obtain legal advice on whether its MRP policy complied with relevant guidance. The Council has not yet obtained this advice or provided it to us. Pending the provision of this advice, our work to address this significant risk remains in progress.

Conclusion

Our work in relation to MRP is ongoing, We will conclude on the risk in our final audit completion report.

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GOING CONCERN

Risk detail

The COVID-19 pandemic has had a significant impact on the Council, including increased demands on the services provided by the Council, reductions in income from services, and the deferral of normal payment terms. While government has provided additional financial support to the Council, it is not clear whether this support will meet the financial impact of COVID-19 on the Council in its entirety. Given the current environment, there is a risk that the Council's financial statements contain insufficient disclosures around going concern

Current conditions and interruption of normal cash flows may result in a local authority having insufficient cash to meet liabilities as the fall due.

Significant risk
Normal risk
Significant management estimate or judgement
Use of experts
Unadjusted error
Adjusted error
Additional disclosure required
Significant control findings to be reported
Letter of representation point

Work ongoing

Our work in realtion to this risk is ongoing, and we are in the process of undertaking the following planned procedures:

- We are reviewing the Council's budgets and cash flow forecasts to evaluate:
  - Whether assumptions around future income and expenditure are appropriate and are based on relevant, reliable data;
  - Whether forecasts indicate periods where cash levels may be insufficient and, if so, management's plans to deal with any shortfalls;
  - The impact on the Council's available reserves, and the reasonableness of any changes to the Council's reserves policy; and
  - The adequacy and appropriateness of disclosures in the financial statements regarding the going concern assessment and any material uncertainties that may exist.
- In addressing this risk, we will also draw upon the work undertaken to address the significant risk identified in relation to sustainable finances, MRP, and the recoverability of loans made by the Council to its subsidiary's.

Conclusion

Our work in relation to going concern is ongoing, We will conclude on the risk in our final audit completion report.

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MATTERS REQUIRING ADDITIONAL CONSIDERATION

Fraud

Whilst officers have ultimate responsibility for prevention and detection of fraud, we are required to obtain reasonable assurance that the financial statements are free from material misstatement, including those arising as a result of fraud. Our audit procedures did not identify any fraud.

Related parties

Whilst you are responsible for the completeness of the disclosure of related party transactions in the financial statements, we are also required to consider related party transactions in the context of fraud as they may present greater risk for management override or concealment or fraud.

We did not identify and significant matters in connection with related parties.

Laws and regulations

We have made enquiries of management regarding compliance with laws and regulations and reviewed correspondence with the relevant authorities.

We did not identify any non-compliance with laws and regulations that could have a material impact on the financial statements.

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We comment below on other reporting required to be considered in arriving at the final content of our audit report:

Matter	Comment
We are required to report on whether the financial and non-financial information in the Narrative Report within the Statement of Accounts is consistent with the financial statements and the knowledge acquired by us in the course of our audit.	Our work on the content of the Narrative Report is in progress.
We are required to report by exception if the Annual Governance Statement is inconsistent or misleading with other information we are aware of from our audit of the financial statements, the evidence provided in the Council's review of effectiveness and our knowledge of the Council.	Our work to review the content of the Annual Governance Statement is in progress.
In the prior year we raised the issue that the format of the Statement of Accounts and financial statements follow an outdated CIPFA model format.	This recommendations was received after the Council had prepared its draft 2019/20 accounts. We will continue to raise this as a recommendation to the Council.

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WHOLE OF GOVERNMENT ACCOUNTS

Matter	Comment
Auditors are required to review Whole of Government Accounts (WGA) information prepared by component bodies that are over the prescribed threshold of £500 million in any of: assets (excluding property, plant and equipment); liabilities (excluding pension liabilities); income or expenditure. The Council falls below the threshold for review and there is no requirement for further work other than to submit the section on the WGA Assurance Statement to the WGA audit team with the total values for assets, liabilities, income and expenditure.	Local authorities were required to submit the unaudited DCT to HM Treasury and auditors by 30 September 2020. HM Treasury have confirmed that a review of the WGA Data Collection Tool (DCT) is no longer required for the 2019/20 accounts.

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OVERVIEW

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money) and report to you on an 'except for' basis. This is based on the following reporting 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.

There are three sub criteria that we consider as part of our overall risk assessment:

- Sustainable resource deployment
- Informed decision making
- Working with partners and other third parties.

As identified in our Audit Planning Report we assessed the following matters as being the most significant risks regarding use of resources.

Audit Risk	Criterion	Risk Rating	Issues identified that impact on conclusion
Sustainable finances	Sustainable resource deployment	Significant	Based on the work we have completed to date, we have not identified any matters to bring to your attention. We will update our assessment in our Audit Completion Report.
Decision making	Informed decision making	Significant	

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SUSTAINABLE FINANCES

Risk description

Facing reduced income from central government, the Council has embarked on a significant investment and regeneration programme to help maintain service levels and off-set the lost income. Significant loans have been taken from the Public Works Loan Board and invested into regeneration projects in the Borough as well as used to acquire investment properties. The ongoing financial environment for the Council remains challenging and there is a risk that savings are not achieved. These risks may have a significant impact on the financial sustainability of the Council in the medium term

The Council will need to deliver it savings and achieve income targets to maintain financial sustainability in the medium term and there is a risk that these projections will not be met.

Significant risk	■
Normal risk	
Sustainable resource deployment	■
Informed decision making	
Working with partners and other third parties	
Significant control findings to be reported	

Work performed

We carried out the following planned audit procedures:

- Reviewed the assumptions used in the Medium Term Financial Strategy and assess the reasonableness of the cost pressures and the amount of Government grant reductions applied;
- Monitored the delivery of the budgeted savings in 2019/20 and the plans to reduce services costs and increase commercial income from 2020/21;
- Reviewed the impact of the significant capital programme on budgets, including the impact on revenue resources, and risk management plans in the event of delays and slippage on revenue generating projects against borrowing and MRP costs; and
- Reviewed the strategies to close the budget gap in the coming years.

Results

Our use of resource work is still in progress. The Council's updated MTFS (November 2021) has the Council needing to use reserves to support a balanced budget of around £15 million stretching to 2025, largely as a result of a reduction in income from commercial property and car parking as well as cost pressures during the pandemic. The Executive are proposing options to find recurrent annual savings of £4.9 million by 2024/25. This will alleviate the pressure on the reserves position. Key assumptions built into the MTFS include:

- An increase in Council Tax in each year of £5.00 at Band D (the maximum allowed under legislation without holding a local referendum);
- Reduction in Government support through business rates retention.
- New Home Bonus to end after 2021/22.
- Provision for loss of income from commercial rents, car parking and leisure set at £5 million.

To conclude our work on this risk, we will draw upon the work undertaken to address the significant risk identified in relation to going concern, MRP, and the recoverability of loans made by the Council to its subsidiary's.

Conclusion

Based on the work to date the Council has a good understanding of the budget requirement in the coming years and has arrangements in place to identify and manage the delivery of required savings. We will update our findings in our Audit Completion Report.

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DECISION MAKING (USE OF RESOURCES)

Risk description

An independent investigation into the Council's decision making procedures concerning the proposed development at the football club noted several weaknesses in governance and managing potential conflicts. Key recommendations included:

- All major development projects should be recognised as such and project management tools applied throughout its lifecycle;
- Legal advice should be presented in reports to Executive and Full Council;
- Risk management templates should be completed for major development projects;
- Project groups should be set up for major development projects;
- The use of Part 2 confidential information should be limited to information not in the public domain and not necessarily to the whole report;
- The Council should avoid appointing statutory officers as directors to external companies; and
- Members of the Planning Committee should not participate in Overview and Scrutiny Committee's review of proposed developments in which planning applications may be submitted.

Significant weaknesses were identified in the Council's arrangements for the preparation of the statement of accounts and supporting working papers.

Significant risk	■
Normal risk	
Sustainable resource deployment	
Informed decision making	■
Working with partners and other third parties	
Significant control findings to be reported	

There is a significant risk regarding the Council's arrangements for decision making regarding major development projects.

Work ongoing

We are carrying out the following planned audit procedures:

- Assessing whether the findings of the independent review demonstrate significant weaknesses in the decision making process, governance and risk management arrangements for major projects; and
- Reviewing the recommendations and how the Council has implemented these.

Results

Our audit work is still in progress and we will comment fully on the effectiveness of the actions taken by the Council to secure improvements in decision making processes in our Audit Completion Report.

Conclusion

Our audit work is still in progress. We will update committee members in our Audit Completion Report on the progress of the implementation of the recommendations and our conclusion on whether a significant weakness exists in the decision making process.

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Under ISAs (UK) and the FRC's Ethical Standard we are required, as auditors, to confirm our independence.

Under ISAs (UK) and the FRC's Ethical Standard, we are required as auditors to confirm our independence.

We have embedded the requirements of the Standards in our methodologies, tools and internal training programmes. Our internal procedures require that audit engagement partners are made aware of any matters which may reasonably be thought to bear on the integrity, objectivity or independence of the firm, the members of the engagement team or others who are in a position to influence the outcome of the engagement. This document considers such matters in the context of our audit for the year ended 31 March 2020.

Details of services, other than audit, provided by us to the Council during the period and up to the date of this report are set out on the following page and were provided in our Audit Planning Report. We understand that the provision of these services was approved by the Standards and Audit Committee in advance in accordance with the Council's policy on this matter.

Details of rotation arrangements for key members of the audit team and others involved in the engagement were provided in our Audit Planning Report.

We have not identified any other relationships or threats that may reasonably be thought to bear on our objectivity and independence.

We confirm that the firm, the engagement team and other partners, directors, senior managers and managers conducting the audit comply with relevant ethical requirements including the FRC's Ethical Standard or the IESBA Code of Ethics as appropriate and are independent of the Council.

We also confirm that we have obtained confirmation of independence from non BDO auditors and external audit experts involved in the audit comply with relevant ethical requirements including the FRC's Ethical Standard and are independent of the Council.

Should you have any comments or queries regarding any independence matters we would welcome their discussion in more detail.

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Fees summary	2019/20 Actual £	2019/20 Planned £	2018/19 Actual £
Audit fee	**TBC**	**80,000**	**107,121**
• Code audit fee: financial statements and use of resources	42,121	42,121	42,121
• Additional fees	(2) TBC	(1) 37,879	(3)65,000
Non-audit assurance services	**TBC**	**15,000**	**10,208**
• Housing benefit	TBC	12,000	7,208
• Capital receipts	TBC	3,000	3,000
Total fees	**TBC**	**95,000**	**117,329**

(1) In our audit plan, we proposed a fee variation to the PSAA scale fee for 2019/20 and discussed this with the Council's Finance staff and the Standards and Audit Committee. This reflects the additional audit work required in response to issues encountered in recent years and significantly greater pressure on auditors to deliver higher quality audits and to demonstrate greater professional scepticism when carrying out their work.

(2) Upon completion of the audit we will discuss final overrun costs with the Director of Finance and report this to you.

(3) We proposed increasing the final fee for 2018/19 by £65,000 to £107,121 based on the additional hours required for this audit at the PSAA grade contracted rates. We have submitted the proposed scale fee variation to PSAA who will now determine the fee.

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OUR RESPONSIBILITIES

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Our responsibilities and reporting

We are responsible for performing our audit under International Standards on Auditing (UK) to form and express an opinion on your financial statements. We report our opinion on the financial statements to those charged with governance for the Council.

We read and consider the 'other information' contained in the Statement of Accounts such as the Narrative Report . We will consider whether there is a material inconsistency between the other information and the financial statements or other information and our knowledge obtained during the audit.

We report where we consider that the Council had not put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We review the Whole of Government Accounts Data Collection Tool provided to HM Treasury and express an opinion on whether it is consistent with the audited financial statements.

What we don't report

Our audit is not designed to identify all matters that may be relevant to the Standards and Audit Committee and cannot be expected to identify all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist.

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ADDITIONAL MATTERS WE ARE REQUIRED TO REPORT

	Issue	Comments
1	Significant difficulties encountered during the audit.	The audit has been very challenging as a result of the Covid-19 lockdown. This has meant that BDO staff have worked remotely during the audit and therefore the face to face communication/ review of files has not been possible resulting in increased time being taken.
2	Written representations which we seek.	We will include a copy of our letter of representation in our Audit Completion Report.
3	Any fraud or suspected fraud issues.	Based on the work we have completed to date, we have no matters to bring to your attention.
4	Any suspected non-compliance with laws or regulations.	Based on the work we have completed to date, we have no matters to bring to your attention.
5	Significant matters in connection with related parties.	Based on the work we have completed to date, we have no matters to bring to your attention.

COMMUNICATION WITH YOU

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Those Charged with Governance (TCWG)

References in this report to Those Charged With Governance are to the Council as a whole. For the purposes of our communication with those charged with governance you have agreed we will communicate primarily with the Standards and Audit Committee.

Communication, meetings and feedback

We request feedback from you on our planning and completion report to promote two way communication throughout the audit process and to ensure that all risks are identified and considered; and at completion that the results of the audit are appropriately considered.

We have met with management throughout the audit process. We have issued regular updates driving the audit process with clear and timely communication, bringing in the right resource and experience to ensure efficient and timely resolution of issues.

Communication	Date (to be) communicated	To whom
Audit Planning Report	4 Mach 2021	Standards and Audit Committee
Audit progress report	3 March 2022	Standards and Audit Committee
Audit completion report	TBC	Standards and Audit Committee
Annual Audit Letter	TBC	Standards and Audit Committee

WORK IN PROGRESS

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The following items are all work in progress with active requests and items under consideration by the audit team:

- Outstanding third party confirmations from London Borough of Hackney and Cornwall Council for borrowings;
- Bank reconciliation support;
- IT general controls that is being carried out by our internal IT team;
- Valuations, including resolution of the Lightbox value;
- Component auditor files review ;
- Subsidiary loan recoverability;
- Consideration of Council's legal advice on MRP Policy;
- Consolidation of the group accounts;
- Capital commitments disclosed in the accounts;
- Repairs and maintenance testing;
- Items recognised under REFCUS;
- NNDR appeals provision;
- Discounts and reliefs in the collection fund;
- Income completeness testing;
- Rental income sample testing;
- Payables sample testing;
- PFI Liability testing;
- Completion of technical and quality reviews by BDO Engagement Lead; and
- Review of final draft accounts.

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FRC ETHICAL STANDARD

Issued in December 2019

In December 2019 the FRC published the Revised Ethical Standard 2019 ('ES'), which is applicable from 15 March 2020. There are some transitionary provisions for services and arrangements that are not currently prohibited under the existing Standard. The ES aims to further strengthen auditor independence and enhance confidence in the profession. The table below provides a high level summary of the key headlines.

Key headlines	Impact
The objective, reasonable & informed third party test	Reinforcement that ethical principles take priority over rules. A need to take care where particular facts and circumstances are either not addressed directly by the rules or might appear to 'work around' the rules, or result in an outcome that is inconsistent with the general principles.
Extra-territorial impact	For group audits where the audited entity has overseas operations, the ES will require all BDO Member firms to be independent of the UK audited entity and its UK and overseas affiliates in accordance with the UK Ethical Standard, irrespective of if their audit work is relied upon.
Contingent fees	Non-audit services with contingent or success-based fee arrangements will be prohibited for audited entities.
Secondments	All secondments/loan staff to audited entities are prohibited with the exception of secondments to public sector entities.
Recruitment and remuneration services	Prohibition on providing remuneration services to audited entities such as advising on the quantum of the remuneration package or the measurement criteria for calculation of the package. In addition, the prohibition on providing recruitment services to an audited entity that would involve the firm taking responsibility for, or advising on the appointment of, any director or employee of the entity.
Non-audit services to a public interest entity (PIE)	Moving to a "white-list" of permitted non-audit services for PIEs. The white-list largely consists of services which are either audit-related or required by law and/or regulation. The provision of services not on the white-list are prohibited. The ES separates those permitted services which are exempt from the 70% fee cap and those services which are subject to the fee cap.
Other entities of public interest ('OEPI')	OEPI is a new term in the Ethical Standard. The FRC have imposed the 'white-list' applicable to PIE audited entities to also apply to OEPIs. OEPIs are entities which, according to the FRC, do not meet the definition of a PIE but nevertheless are of significant public interest to stakeholders. They include AIM listed entities which exceed the threshold to be an *SME listed entity* - generally those with a market cap of more than €200m; Lloyd's syndicates; Private sector pension schemes with more than 10,000 members and more than £1billion of assets; Entities that are subject to the governance requirements of The Companies (Miscellaneous Reporting) Regulations 2018 (SI/2018/860), excluding fund management entities which are included within a private equity or venture capital limited partnership fund structure. These would be entities which: – Have more than 2000 employees; and / or – Have a turnover of more than £200 million and a balance sheet total of more than £2 billion. The FRC have noted that the rules applicable to OEPIs will apply from periods commencing on or after 15 December 2020.

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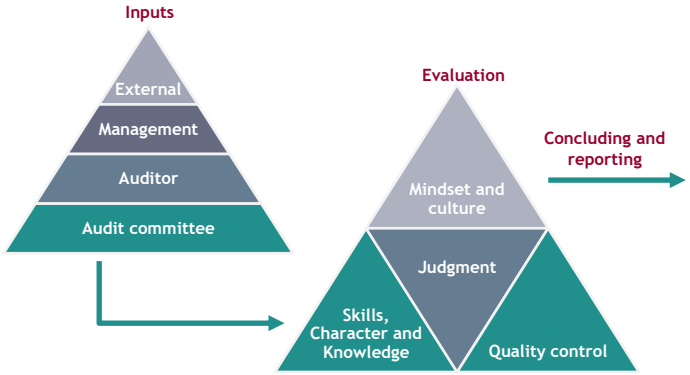
FRC PRACTICE AID FOR AUDIT COMMITTEES

The FRC issued an updated practice aid for audit committees in December 2019 and a full copy can be found on the **FRC website**. In their practice aid the FRC note: 'The directors of a company (the Board as a whole) are responsible for ensuring its financial statements are prepared in accordance with the applicable financial reporting framework and for overseeing the company's internal control framework. A high-quality audit provides investors and other stakeholders with a high level of assurance that the financial statements of an entity give a true and fair view and provide a reliable and worthy basis for taking decisions.'

The practice aid then discusses how the role of audit committees in serving the interests of investors and other stakeholders is through their independent oversight of the annual corporate reporting process including the audit. The FRC highlight that the responsibility for appointing the external auditor, approving their remuneration and any non audit services work, ensuring their independence and challenging them over the quality of their work falls to the audit committee and can play a key role in facilitating a high quality audit (see note below).

It gives guidance for Audit Committees in the following areas:

- Audit tenders and the tender process including audit fee negotiations and auditor independence
- A model for use by audit committees in making an overall assessment of an external auditor including inputs, evaluations and concluding:



- Transparency - reporting to the Board on how the audit committee has discharged these responsibilities
- Some guidance on key areas of audit judgement

The provision of high quality audits are a key focus of FRC and the new Executive Director of Supervision, David Rule, sent a letter to all audit firms in November 2019 explaining the factors he would expect to see in place in order to facilitate the delivery of high quality audits. A copy of the letter can be found on the **FRC website**.

AUDIT QUALITY

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BDO is totally committed to audit quality

It is a standing item on the agenda of BDO's Leadership Team who, in conjunction with the Audit Stream Executive (which works to implement strategy and deliver on the audit stream's objectives), monitor the actions required to maintain a high level of audit quality within the audit stream and address findings from external and internal inspections.

BDO welcomes feedback from external bodies and is committed to implementing a necessary actions to address their findings.

We recognise the importance of continually seeking to improve audit quality and enhancing certain areas. Alongside reviews from a number of external reviewers, the AQR (the FRC's Audit Quality Review team), QAD (the ICAEW Quality Assurance Department) and the PCAOB (Public Company Accounting Oversight Board who oversee the audits of US companies), the firm undertakes a thorough annual internal Audit Quality Assurance Review and as member firm of the BDO International network we are also subject to a quality review visit every three years.

We have also implemented additional quality control review processes for all listed and public interest audits.

More details can be found in our Transparency Report at www.bdo.co.uk

FOR MORE INFORMATION:

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The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the company and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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