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Tandridge District Council

Planning report to the Audit and Scrutiny Committee for the 2020/21 audit

24 March 2021

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Audit and Scrutiny Committee
Tandridge District Council
8 Station Road East,
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24 March 2021

Dear Chair,

Statutory audit of the financial statements of the Tandridge District Council ("the Council") for the year ended 31 March 2021.

We have pleasure in setting out in this report the principal matters that we will focus on during our audit of Tandridge District Borough Council (the Council) for the period ended 31 March 2021. This letter covers those matters which Auditing Standards require us to communicate to those charged with governance (the "Audit and Scrutiny Committee").

Audit Scope	Our principal audit objective is to obtain sufficient, relevant and reliable audit evidence to enable us to express an opinion on the statutory accounts of the Council prepared in accordance with the Code of Practice on Local Authority Accounting ("the Code") issued by CIPFA for the period ending 31 March 2021. We will conduct our audit in accordance with International Standards on Auditing (UK) ("ISA UK") as adopted by the UK Auditing Practices Board ("APB") and Code of Audit Practice issued by the National Audit Office. We anticipate that the Council will continue to be the only individually significant component for the group audit. The group audit team will perform central procedures on the Council's subsidiary, including considering property valuations as part of our significant risk procedures.
Significant Audit Risks	Our initial risk assessment has identified the following significant audit risks, discussed further on pages 5-6: • Completeness of creditors and related expenditure; • Property Valuations; and • The potential risk of management override. We will update our risk assessment following completion of the 2019/20 audit.
Other Areas of Audit Focus	Other matters which we have not currently identified as significant audit risks for the 2020/21 audit, but which will be areas of audit focus (and whose risk we will reassess as more information becomes available), include: • Pensions Valuations; and • Covid-19 related accounting and disclosures (discussed further on pages 3-5)
Value for Money	The National Audit Office's 2020 Code of Audit Practice revises the scope of the required work of the auditor on bodies' arrangements to secure value for money, moving away from a binary conclusion on arrangements in the audit report to a narrative commentary in a new "Auditor's Annual Report" (which replaces the Annual Audit Letter). The new requirements in this area are discussed further on page 9.
Materiality	We plan to set materiality based on 2% of gross expenditure (included in the surplus/deficit on provision of services) in the draft financial statements as the benchmark for determining materiality which is consistent with prior year. We report to the you on all unadjusted misstatements greater than 5% of materiality for the financial statements and other adjustments that are qualitatively material.

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COVID-19 pandemic and its impact on our audit.

Requirements

CIPFA has issued guidance highlighting the importance of considering the impact of COVID-19 in preparation of the financial statements, including communicating risks and governance impacts in narrative reporting. This is consistent with the Financial Reporting Council's guidance to organisations on the importance of communicating the impact of COVID-19 and related uncertainties, including their impact on resilience and going concern assessments.

Entity-specific explanations of the current and expected effects of COVID-19 and the Council's plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation.

As well as the effects upon reserves, financial performance and financial position, examples of areas highlighted by CIPFA include the impact on service provision, changes to the workforce and how they are deployed, impacts upon the supply chain, cash flow management, and plans for recovery. Risks highlighted include those relating to subsidiaries and investments, capital programmes, and resilience of the community including partner organisations and charities.

Actions

We therefore expect a thorough assessment of the current and potential future effects of the COVID-19 pandemic including:

- A detailed analysis across the Council's operations, including on its income streams, supply chains and cost base, and the consequent impacts on financial position and reserves;
- The economic scenario or scenarios assumed in making forecasts and on the sensitivities arising should other potential scenarios materialise (including different funding scenarios);
- Uncertainties relating to the council's financial position, and the potential requirement for a section 114 notice; and
- The effect of events after the reporting date, including the nature of non-adjusting events and an estimate of their financial effect, where possible.

Impact on the Council

We will consider the key impacts on the business such as:

- Interruptions to service provision
- Supply chain disruptions
- Unavailability of personnel
- Reductions in income
- The closure of facilities and premises

Impact on annual report and financial statements

We have considered the impact of the outbreak on the annual report and financial statements, discussed further on the next slide including:

- Principal risk disclosures
- Impact on property, plant and equipment
- Valuation of commercial or investment properties
- Impact on pension fund investment measurement and impairment
- Sustainability of the Council and going concern assessment
- Events after the reporting period and relevant disclosures
- Bad debts provision policy
- Narrative reporting
- Impairment of non-current assets
- Allowance for expected credit losses

Impact on our audit

We will consider the impact on the audit including:

- Resource planning
- Timetable of the audit
- Impact on our risk assessment
- Logistics including meetings with entity personnel

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Impact on annual report and financial statements	
Impact on property, plant and equipment	The Royal Institute of Chartered Surveyors issued a practice alert in March 2020, as a result of which valuers have identified a material valuation uncertainty at 31 March 2020 for most types of property valuation, resulting in disclosure in financial statements and "emphasis of matter" paragraphs in audit reports. By September 2020, RICS considered that there was no longer material uncertainty over valuations from that date, and therefore valuations at 31 March 2021 are not expected to be affected by material valuation uncertainties. However, the on-going financial impact of the pandemic has impacted valuations, both through demand for particular asset types and weakening the financial standing of tenants. The Council needs to consider its approach to the measurement of property, plant and equipment (PPE). Where property held at current value is based on market valuations the Council should consider with their valuers the impact that COVID-19 has had on current value. The Council will also need to consider whether there are any indications of impairment of assets requiring adjustment at 31 March 2021.
Valuation of commercial or investment properties	Following the COVID-19 pandemic, the fair value measurements for financial instruments and investment properties held by the Council needs to be reviewed against the conditions and assumptions at the measurement date. Although volatility is lower relative to 31 March 2020, there have been significant market movements during the year which may impact valuations.
Impact on pension fund investment measurement	As a result of the COVID-19 pandemic pension fund investments have been subject to volatility. It is important to engage early with custodians and fund managers to not only gather information for year-end measurements but to also understand any estimation techniques and any changes to those techniques that may be needed to measure the financial instruments. Where such volatility exists it may mean that the inputs used in the fair value measurement may change and may require a change of measurement technique, and consideration of the level of uncertainty in valuations where there is significantly more estimation.
Expected credit losses	Since 31 March 2020, there has been a significant downturn in economic activity, with many businesses and individuals significantly impacted. The Council will need to consider the provision for credit losses for receivables, including for expected credit losses for assets accounted for under IFRS 9.

Impact on annual report and financial statements	
Financial risk disclosures	The Council needs to report on the impact of financial pressures and its financial sustainability in the narrative report and the relevant liquidity reporting requirements under the Code's adoption of IFRS 7 Financial Instruments: Disclosures.
Narrative and other reporting issues	The following areas will need to be considered by local authorities as having being impacted on by the COVID-19 pandemic. • Narrative reporting as well as the usual reporting requirements will need to cover the effects of the pandemic on services, operations, performance, strategic direction, resources and financial sustainability. These will need to reflect the significant financial challenge that the Council has experienced, and the ongoing work on budgets which has been undertaken in the year. Reporting judgements and estimation uncertainty, the Council will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities
Events after the reporting period	The economic environment and impact of the pandemic continues to be highly uncertain. The Council will need to consider the events after the Reporting Period and whether these events will be adjusting or non-adjusting and make decisions on a transaction by transaction basis. The nature of the COVID-19 pandemic will mean that the Council will need to continue to review and update these assessments up to the date the accounts are authorised for issue.

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Significant audit risks

Completeness of creditors and related expenditure

Risk Identified

Under UK auditing standards, there is a presumed risk in respect of revenue recognition due to fraud. We have rebutted this risk, and instead believe that the fraud risk lies with the completeness of expenditure, in particular the completes of accruals and provisions.

For 2020/21, the current approved budget Council was for net expenditure of £11.3m. Given the Council's current budget position and the pressures across the whole of the public sector, there is an inherent risk that the year-end position could be manipulated by omitting or misstating accruals and provisions. There is also a heightened risk of costs being omitted due to the on-going impact on ways of working at the council and in suppliers and in light of the extremely challenging financial position at the council.

Our response

Our work in this area will include the following:

- We will obtain an understanding of the design and implementation of the key controls in place in relation to recording completeness of accruals and provisions.
- We will perform focused testing in relation to the completeness of expenditure including a detailed review of accruals and provisions;
- As part of this focused testing we will challenge any assumptions made in relation to year-end accruals and provisions, including inquiring with the legal department in respect of the existence of known and potential claims (and where relevant undertake a review of legal letters in respect of cases); and
- In addition, we will review the year on year movement in accruals and provisions and will investigate any significant downwards movements.

Property valuation

Risk identified

The Council held £345.7m of land and buildings (including dwellings) at 31 March 2020 and £21.7m of investment properties.

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate current value at that date. The Council's land and buildings are revalued every five years, on a rolling basis with a desk top revaluation review carried out annually to identify any material changes to assets not revalued in the year. As a result of this, however, individual assets may not be revalued for four years. Although assets are currently held at 31 March 2020 valuations, given the market movements in 2020/21 there may be larger than usual movements in the year. There is therefore a risk that that the carrying value of assets not included in the Council's revaluation process in the current year materially differ from the year end fair value. Investment properties are valued each year.

In addition, given the material value of the assets, and judgemental valuation assumptions, there is a risk that property balances may be materially misstated.

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Significant audit risks - Continued

Our response

- We will understand how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation;
- We will review any revaluations performed in the year, assessing whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals;
- We will use our valuation specialists (Deloitte Real Estate) where considered appropriate, to support our review and challenge the appropriateness of the assumptions used in the year-end valuation of the Council’s Land and Buildings;
- We will test the inputs provided to the valuer; and
- We will test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts.

Management Override of Controls

Risk identified

In accordance with ISA 240 (UK) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risks and areas of audit interest: completeness of expenditure, valuation of the Council’s estate and valuation of the pension liability. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Our response

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

- We will test the design and implementation of key controls in place around journal entries and management estimates;
- We will risk assess journals and select items for detailed testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest;
- We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting;
- We will review accounting estimates for biases that could result in material misstatements due to fraud in line with ISA 540 requirements; and,
- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the Council, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

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Other Areas of Audit Focus

Pensions Valuations

Risk Identified

The Council are part of the Local Government Pension Scheme administered by Surrey County Council. At 31 March 2020, the Council recognised a net pensions liability of £50.9m with a defined benefit obligation of £119.9m and asset value of £69.0m. The Code requires that their year end carrying value should reflect the appropriate fair value at that date. We note that as at 31 March 2020, the pension scheme auditor included an emphasis of matter in their opinion in respect of material uncertainty over the valuation of property assets.

Hymans Robertson act as the Council's expert actuary, who produce a report outlining the liability and disclosures required for each council.

Our response

We carry out a separate, detailed risk assessment of each of the individual components of the liability calculation (for example market assumptions, membership data, assets and liabilities) using a developed methodology which takes into account factors such as an assessment of the actuary. We will also liaise with the scheme auditor on the results of their audit procedures on the scheme as a whole.

We will consider the make-up of the pension assets and the extent to which the asset types have been valued based on observable market prices or using estimation and judgement in the valuation and consider the extent of uncertainty in the asset valuation and the impact on our approach.

We scope our work, including the nature and extent of our actuarial specialists involvement, in a way which responds to this detailed risk assessment. Should our risk assessment change our overall audit approach in respect of testing pensions, we will notify the Committee.

We will confirm the disclosure of the pension figures in the statement of accounts agree with those provided by the scheme actuary.

Value for Money

We are required to consider the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources. Under the revised requirements of the Code of Audit Practice 2020 and related Auditor Guidance Note 03, we are required to:

- Perform work to understand the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources against each of the three reporting criteria:
  - **Financial sustainability:** How the body plans and manages its resources to ensure it can continue to deliver its services.
  - **Governance:** How the body ensures that it makes informed decisions and properly manages its risks.
  - **Improving economy, efficiency and effectiveness:** How the body uses information about its costs and performance to improve the way it manages and delivers its services.
- Undertake a risk assessment to identify whether there are any risks of significant weaknesses in arrangements;
- If any risks of significant weaknesses are identified, perform procedures to determine whether there is in fact a significant weakness in arrangements, and if so to make recommendations for improvement;
- Issue a narrative commentary in the Auditor's Annual Report (which replaces the Annual Audit Letter), setting out the work undertaken in respect of the reporting criteria and our findings, including any explanation needed in respect of judgements or local context for findings. If significant weaknesses are identified, the weaknesses and recommendations will be included in the reporting, together with follow-up of previous recommendations and whether they have been implemented. Where relevant, we may include reporting on any other matters arising we consider relevant to VfM arrangements, which might include emerging risks or issues.
- Where significant weaknesses are identified, report this by exception within our financial statement audit opinion.

The National Audit Office and the audit firms are continuing to discuss the practical implementation of these new requirements and expectations as to the extent of procedures underpinning these requirements, including the timetable required for VfM work and reporting for 2020/21. Expectations in this area are likely to continue to evolve as practical issues emerge in implementation.

Specific areas that we expect to focus on in understanding the Council's arrangements include the Council's response to the financial pressures from Covid-19 in 2020/21, and the Council's longer term planning for financial sustainability.

The NAO are expecting to release updated Auditor Guidance shortly confirming 2020/21 reporting timelines

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Scope of work and approach

Key areas of responsibility under the Audit Code of Practice	**Financial statements** We will conduct our audit in accordance with International Standards on Auditing (UK) ("ISA UK") as adopted by the UK Auditing Practices Board ("APB") and Code of Audit Practice issued by the NAO. The Council will prepare its accounts under the Code of Practice on Local Council Accounting ("the Code") issued by CIPFA and Local Authority (Scotland) Accounts Authority Committee (LASAAC). We are also required to issue a separate assurance report to the NAO on the Council's separate return required for the purposes of its audit of the Whole of Government Accounts and departmental accounts. **Annual Governance Statement** We are required to consider the completeness of the disclosures in the Annual Governance Statement in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and other work. As part of our work we will review the annual report and compare with other available information to ensure there are no material inconsistencies. We will also review any reports from other relevant regulatory bodies and any related action plans developed by the Council. **Value for Money conclusion** We are required to satisfy ourselves that the Council has made proper arrangements for securing financial resilience and economy, efficiency and effectiveness in its use of resources, as discussed further on page 9.
Our approach	**Liaison with internal audit** The Auditing Standards Board's version of ISA UK 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements. We will review their reports and meet with them where necessary to discuss their work. We will review the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work. **Approach to controls testing** Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I"). The results of our work in obtaining an understanding of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

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Audit fees

The “scale fee” set by Public Sector Auditor Appointments Limited for the financial statement audit, including whole of government accounts and procedures in respect of the value for money assessment, is £35,536.

For 2021, there are on-going discussions with PSAA in respect of scale fees. We will propose the fee for 2021 following completion of the 2020 audit. We would highlight that we would expect there to be potentially significant fee increases reflecting a number of changes in 2021 including the requirements of the revised Code of Audit Practice in particular in respect of Value for Money, the increased requirements on audit of accounting estimates under the revised ISA 540, and wider regulatory changes increasing the cost of audit delivery (and in 2022 for the implementation of IFRS 16, Leases).

Overrun fees for FY19 and FY20 remain open.

Independence

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of Tandridge District Council and will reconfirm our independence and objectivity to the Audit and Scrutiny Committee for the year ending 31 March 2021 in our final report to the Audit and Scrutiny Committee. We have not undertaken any non-audit services in the year.

We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

As part of our obligations under International Standards on Auditing (UK) and the APB’s Ethical Standards we are required to report to you on all relationships (including the provision of non-audit services) between us and the audited entity.

We confirm all Deloitte network firms are independent of the Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Fraud responsibilities and representations

Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Inquiries

We will make the inquiries regarding management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.

Whether management, internal audit and those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud, including process for identifying and responding fraud and communication of fraudulent behaviour.

How those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.

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Audit timings	Current proposals are for draft accounts publication by 1 August for public inspection, and final accounts by 30 September – however, this remains subject to change as this timeframe doesn't allow sufficient time for audit. We understand that the council plan to prepare their accounts ahead of this timetable, thus allowing us to plan to commence our testing in late June.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope; and
- Key regulatory and corporate governance updates, relevant to you.

Use of this report

This report has been prepared for the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

We will update you if there are any significant changes to the audit plan.

Deloitte LLP

St Albans, 24 March 2021