



Gloucester City Council

Audit and Governance Committee

Meeting: Monday, 21st January 2019 at 6.30 pm in Civic Suite - North Warehouse, The Docks, Gloucester, GL1 2EP

Membership:	Cllrs. Gravells (Chair), Melvin (Vice-Chair), Brooker, D. Norman, Smith, Stephens and Wilson
Contact:	Democratic and Electoral Services 01452 396126 democratic.services@gloucester.gov.uk

AGENDA

10.	DELOITTE - EXTERNAL AUDIT PLAN 2018/19 (Pages 5 - 26) To consider the External Audit Plan as prepared by Deloitte.
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Jon McGinty
Managing Director

Date of Publication: Friday, 11 January 2019

NOTES

Disclosable Pecuniary Interests

The duties to register, disclose and not to participate in respect of any matter in which a member has a Disclosable Pecuniary Interest are set out in Chapter 7 of the Localism Act 2011.

Disclosable pecuniary interests are defined in the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012 as follows –

<u>Interest</u>	<u>Prescribed description</u>
Employment, office, trade, profession or vocation	Any employment, office, trade, profession or vocation carried on for profit or gain.
Sponsorship	Any payment or provision of any other financial benefit (other than from the Council) made or provided within the previous 12 months (up to and including the date of notification of the interest) in respect of any expenses incurred by you carrying out duties as a member, or towards your election expenses. This includes any payment or financial benefit from a trade union within the meaning of the Trade Union and Labour Relations (Consolidation) Act 1992.
Contracts	Any contract which is made between you, your spouse or civil partner or person with whom you are living as a spouse or civil partner (or a body in which you or they have a beneficial interest) and the Council (a) under which goods or services are to be provided or works are to be executed; and (b) which has not been fully discharged
Land	Any beneficial interest in land which is within the Council's area. For this purpose "land" includes an easement, servitude, interest or right in or over land which does not carry with it a right for you, your spouse, civil partner or person with whom you are living as a spouse or civil partner (alone or jointly with another) to occupy the land or to receive income.
Licences	Any licence (alone or jointly with others) to occupy land in the Council's area for a month or longer.
Corporate tenancies	Any tenancy where (to your knowledge) – (a) the landlord is the Council; and (b) the tenant is a body in which you, your spouse or civil partner or a person you are living with as a spouse or civil partner has a beneficial interest
Securities	Any beneficial interest in securities of a body where – (a) that body (to your knowledge) has a place of business or land in the Council's area and (b) either – i. The total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body; or ii. If the share capital of that body is of more than one class, the total nominal value of the shares of any one class in which you, your spouse or civil partner or person with

whom you are living as a spouse or civil partner has a beneficial interest exceeds one hundredth of the total issued share capital of that class.

For this purpose, "securities" means shares, debentures, debenture stock, loan stock, bonds, units of a collective investment scheme within the meaning of the Financial Services and Markets Act 2000 and other securities of any description, other than money deposited with a building society.

NOTE: the requirements in respect of the registration and disclosure of Disclosable Pecuniary Interests and withdrawing from participating in respect of any matter where you have a Disclosable Pecuniary Interest apply to your interests and those of your spouse or civil partner or person with whom you are living as a spouse or civil partner where you are aware of their interest.

Access to Information

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For enquiries about Gloucester City Council's meetings please contact Democratic Services, 01452 396126, democratic.services@gloucester.gov.uk.

If you, or someone you know cannot understand English and need help with this information, or if you would like a large print, Braille, or audio version of this information please call 01452 396396.

Recording of meetings

Please be aware that meetings may be recorded. There is no requirement for those wishing to record proceedings to notify the Council in advance; however, as a courtesy, anyone wishing to do so is advised to make the Chair aware before the meeting starts.

Any recording must take place in such a way as to ensure that the view of Councillors, Officers, the Public and Press is not obstructed. The use of flash photography and/or additional lighting will not be allowed unless this has been discussed and agreed in advance of the meeting.

FIRE / EMERGENCY EVACUATION PROCEDURE

If the fire alarm sounds continuously, or if you are instructed to do so, you must leave the building by the nearest available exit. You will be directed to the nearest exit by council staff. It is vital that you follow their instructions:

- You should proceed calmly; do not run and do not use the lifts;
- Do not stop to collect personal belongings;
- Once you are outside, please do not wait immediately next to the building; gather at the assembly point in the car park and await further instructions;
- Do not re-enter the building until told by a member of staff or the fire brigade that it is safe to do so.

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Planning report to the Audit and Governance Committee for the year ending 31 March 2019

January 2019

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Introduction

The key messages in this report:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.

• A strong understanding of your internal control environment.

- A well planned and delivered audit that raises findings early with those charged with governance.

We have pleasure in presenting our planning report to the Audit and Governance Committee (the Committee) for the 2019 audit of Gloucester City Council (the Council). We would like to draw your attention to the key messages of this paper:

Audit Plan

- We are developing our understanding of the Council through discussion with management and review of relevant documentation from across the Council.
- Based on these procedures, we have developed this plan in collaboration with the Council to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the Council.

Key risks

- We have taken an initial view as to the significant audit risks that the Council faces. These are presented as a summary dashboard on page 11.

Regulatory change

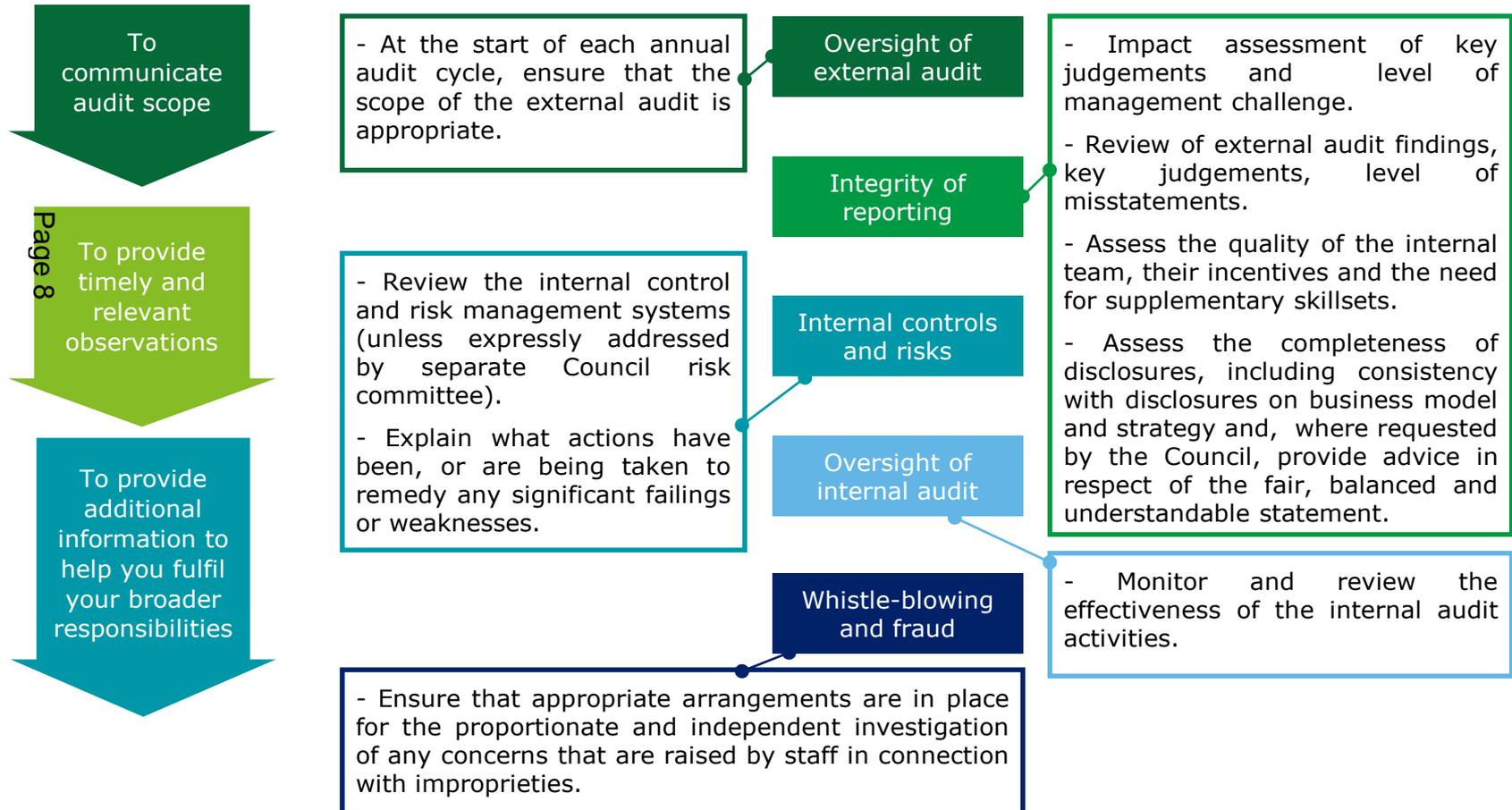
- Our audit is carried out under the Code of Audit Practice issued by the National Audit Office (NAO).
 - We will update Management and the Committee with sector and technical updates as they arise.
-

Responsibilities of the Audit and Governance Committee

Helping you fulfil your responsibilities

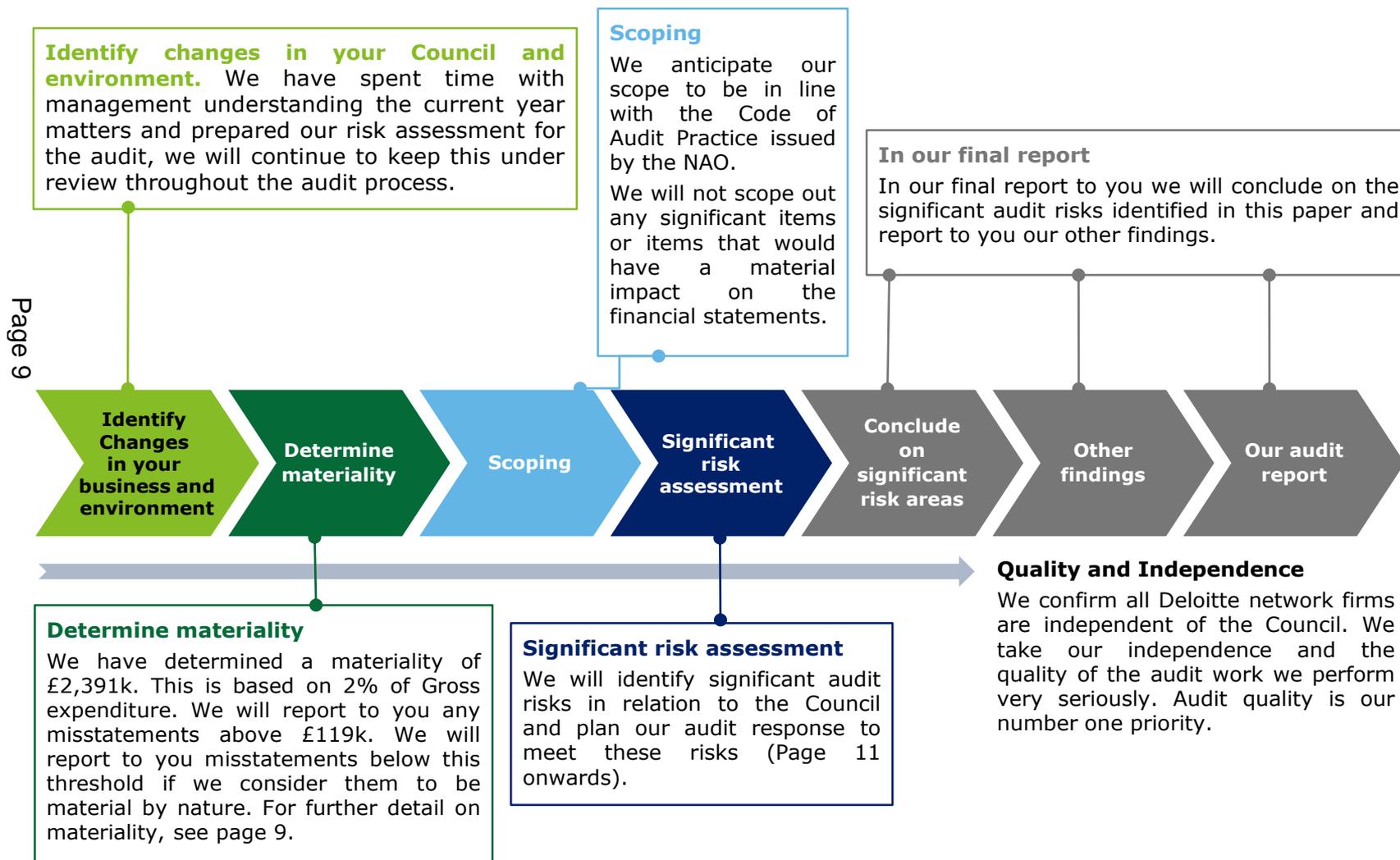
Why do we interact with the Audit and Governance Committee?

As a result of regulatory change in recent years, the role of the Audit and Governance Committee has significantly expanded. We set out here a summary of the core areas of Audit and Governance Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit and Governance Committee in fulfilling its remit.



Our audit explained

We tailor our audit to your Council and your strategy



Scope of work and approach

Scope: we have three 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.

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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.

To perform this work, we are required to:

- plan our work based on consideration of the significant risks of giving a wrong conclusion; and
- carry out as much work as is appropriate to enable us to give a safe conclusion on the arrangements to secure VFM.

Our work therefore includes a detailed risk assessment based on the risk factors identified in the course of our audits. This is followed by specific work focussed on the risks identified. To date no significant risks around VFM have been identified,

We then provide a conclusion on these arrangements as part of our final reporting to you.

Scope of work and approach

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.

Using these discussions to inform our risk assessment, we can work together with internal audit where necessary to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

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.

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Council complete the Code checklist during drafting of their financial statements.

We would like the opportunity to review a skeleton set of financial statements and an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management.

Value for Money and other reporting

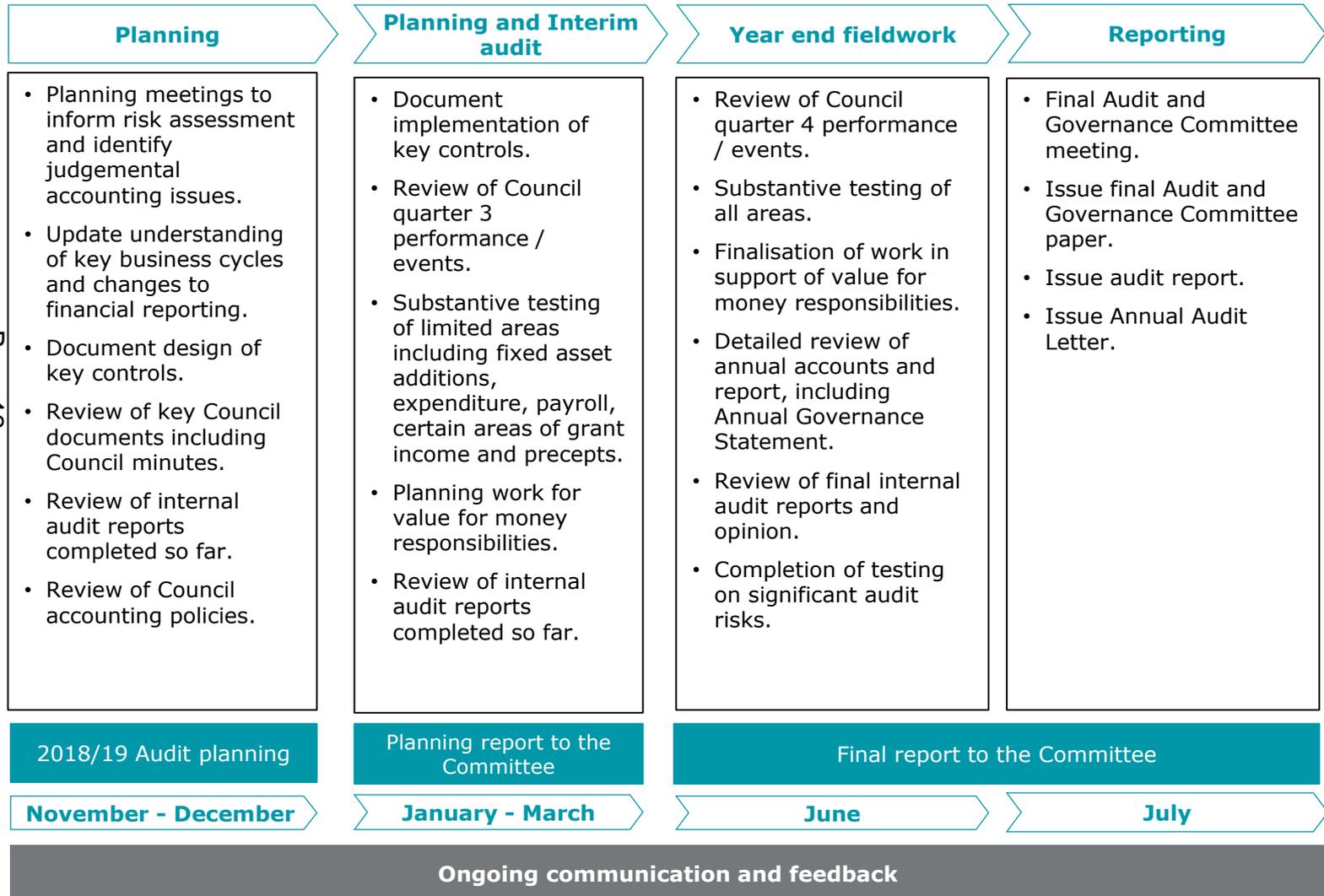
The Code of Audit Practice requires us to report by exception in our audit report any matters that we identify that indicate the Council has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.



Continuous communication and reporting

Planned timing of the audit

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Materiality

Our approach to materiality

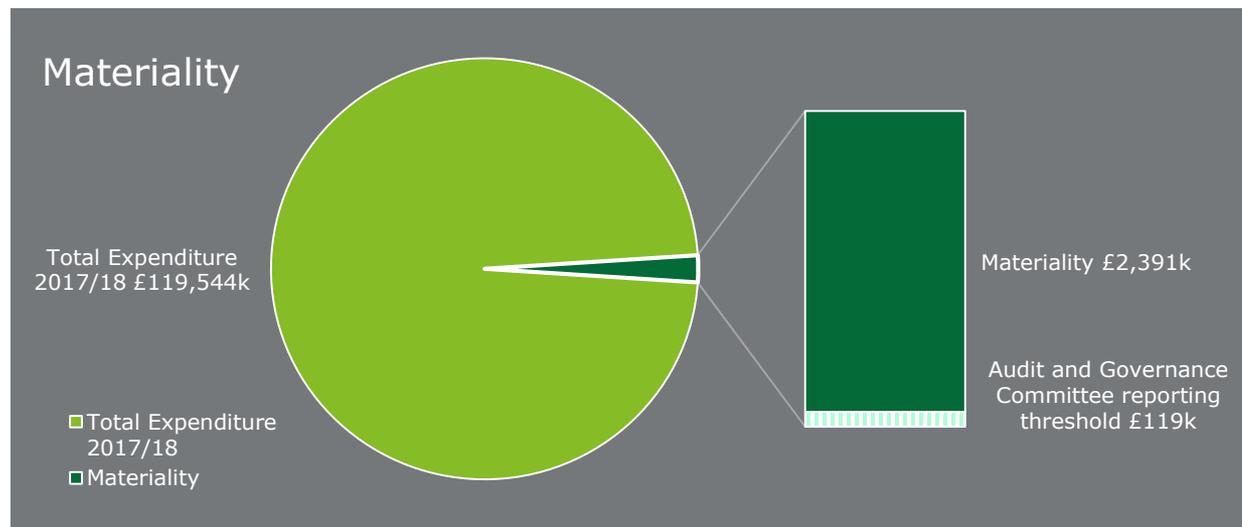
Basis of our materiality benchmark

- The audit partner has determined materiality as £2,391k, based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of Gross Expenditure up to the surplus/deficit on provision of services based on the 2017/18 audited accounts as the benchmark for determining materiality. We will re-assess this position at interim and update materiality according to the year-end position. Note the Group materiality applied will be £2,415k.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £119k.
- We will report to you misstatements below this threshold if we consider them to be material by nature.

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Although materiality is the judgement of the audit partner, the Audit and Governance Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements; and
- the Council's actual and planned performance on financial and other relevant metrics.

Principal risk and uncertainties

- Cyber security
- Regulatory
- Economic environment and future levels of funding
- Impairment
- BREXIT

Changes in your business and environment

- No significant changes

IAS 1 Critical accounting estimates included in the statement of accounts

- Useful lives of assets
- Pension liability
- Provision for Business Rates Appeal
- Arrears

Significant Audit Risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls	Level of management judgement	Expected to be included in our report to the Audit and Governance Committee	Slide no.
Completeness of Expenditure			D+I			12
Management Override of Controls			D+I			13

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D+I: Assessing the design and implementation of key controls

Low Level of Judgement



Medium Level of Judgement



High Level of Judgement



Significant Audit Risks

Risk 1 – Completeness of Expenditure

Risk identified

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

For 2018/19, the Council approved a budget with a net cost of service of £13.9m. As at September 2018, the Council reported a forecast overspend of £191k, but that they are working towards a balanced position which was achieved in 2017/18. 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.

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; and

In addition, we will review the year on year movement in accruals and provisions and will investigate any significant downwards movements as well as year-end outturns versus budget forecasts.

Significant Audit Risks

Risk 2 – 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 and valuation of the Council's estate and 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; 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.

Other Areas of Audit Interest

Pensions Liability Valuation

Risk identified

The Council are part of the Local Government Pension Scheme operated by Gloucestershire County Council. The Council recognised a combined pensions liability of £68.6m at 31 March 2017 which decreased to £64m as at 31 March 2018. The Code requires that their year end carrying value should reflect the appropriate fair value at that date.

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

The pensions valuation is an area of audit interest due to the material values attached to the valuations and disclosures in the financial statements.

Our response

We carry out a separate, detailed risk assessment of each of the individual components of the 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 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.

Other Areas of Audit Interest

Property Valuation

Risk identified

The Council held £60.5m of property assets (land and buildings) at 31 March 2017 which increased to £65.3m as at 31 March 2018. The increase was in part due to upwards revaluations of £2.3m as a result of the Council undertaking a valuation exercise during 2017/18, as well as transfers between classes accounting for a £3.3m increase in property valuation.

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years. There is therefore a risk 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.

In addition, we will review whether there have been any further developments in relation to the Kings Walk Shopping Centre in the current year since this was an area of focus for the year ended 31 March 2018.

Note: The property valuation is an area of audit interest as even though the year-end valuations are material they are performed by an independent expert on assets of a unique nature, whereby the valuations should not materially change year-on-year.

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; 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.

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
Cardiff, January 2019

Appendices

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Fraud responsibilities and representations

Responsibilities explained



Your 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.



Our responsibilities:

- 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.
- As set out in the significant risks section of this document, we have identified the risk of fraud in completeness of expenditure, and management override of controls as a key audit risk for your organisation.

Fraud Characteristics:

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Council:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.



Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:



Management:

- 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.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.
- We plan to involve management from outside the finance function in our inquiries.

Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

Those charged with governance

- 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.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.



Fees and Independence

The professional fees expected to be charged by Deloitte LLP in the period from 1 April 2018 to 31 March 2019 are as follows:

	Current year £ (excluding VAT)
Financial statement audit including Whole of Government Accounts where applicable and procedures in respect of Value for Money assessment	48,857
Total audit	48,857
Total fees	48,857

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

Our approach to quality

AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

All the AQR public reports are available on its website. <https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

The AQR's 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

The firm has enhanced its policies and procedures in the following areas:

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

Our key findings in the current year requiring action by the firm:

- Improve the group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.

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