Stevenage Borough Council

Initial Audit Planning Report

Year ended 31 March 2020

June 2020

Building a better working world

Private and Confidential
Stevenage Borough Council
Daneshill House
Danestrete
Stevenage,
SG1 1HN

28 May 2020

Dear Audit Committee Members

Audit Planning Report

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2019/20 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This Plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks. Our planned audit strategy and risk assessment was substantially completed prior to the unprecedented events with the COVID-19 outbreak and social distancing measures introduced in the United Kingdom from the end of March 2020. We have adapted our audit approach and working practices to take account of the implications and risks from COVID-19 as we see them for the preparers of financial statements and auditors for Local Government bodies. We have had initial discussions with the Council's finance team on their response and ongoing strategic, operational and financial risk assessment. We will continue to keep this area under review during the course of our audit and update our audit risk assessment and approach as appropriate. At this stage, we expect to be undertaking additional audit procedures on the valuation of the Council's assets, recognition of grant income and our assessment of management's assertions and disclosures associated with preparing the accounts as a going concern in accordance with the Financial Reporting Council's Statement of Recommended Practice Note 10 for audit of public sector bodies in the United Kingdom.

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Audit Committee

Stevenage Borough Council

28 May 2020

We have updated our audit risk assessment to respond to the heightened risks and public profile associated with the Council's increasingly fragile financial position as a result of the impact of COVID-19. This includes a reduction to our audit performance materiality compared to the prior year as well as increased audit risks and testing associated with accounting judgements that could be used to provide a short to medium term revenue and general fund benefit to the Council. In addition, we expect to perform detailed audit procedures as part of our work on going concern assessing the robustness of management's documented consideration of the Council's viability and cashflow position looking twelve months from the date the accounts are authorised for issue. We will need to determine the implications for our audit reporting and responsibilities in the event the Council and/or ourselves were to identify a material uncertainty and if during the course of our audit there becomes a higher likelihood that the CFO would exercise statutory reporting responsibilities under s114 of the Local Government Finance Act 1988 in warning that expenditure is likely to exceed incoming resources (e.g. not being able to deliver a balanced budget).

These additional audit risks and procedures will increase the scope of our work and lead to additional audit fees. We have set out our provisional estimate of the implications for the scope of our work and audit fee throughout this report.

This report is intended solely for the information and use of the Audit Committee and management, and is not intended to be and should not be used by anyone other than these specified parties. We welcome the opportunity to discuss this report with you on 9 June 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully
Neil Harris, Associate Partner

For and on behalf of Ernst & Young LLP

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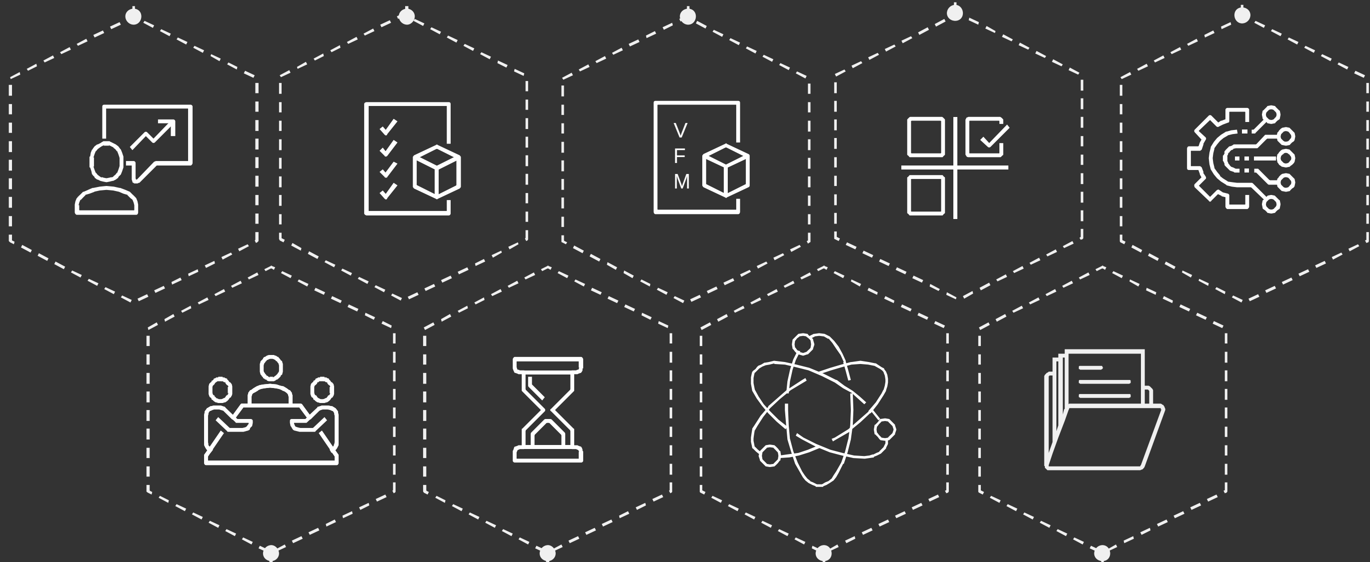

Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit Committee and management of Stevenage Borough Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Stevenage Borough Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Stevenage Borough Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

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01 Overview of our 2019/20 audit strategy

Overview of our 2019/20 audit strategy

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

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error (Risk of management override)	Fraud risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below.
Inappropriate capitalisation of revenue expenditure	Fraud risk	No change in risk or focus	As noted above we have considered the main areas where management may have the incentive and opportunity to do override controls. We have identified the inappropriate capitalisation of revenue expenditure on property, plant and equipment as an area of risk, given the extent of the Authority's capital programme and regeneration schemes.
Misclassification of capital receipts as revenue	Fraud Risk	New risk	The adjustments between accounting basis and funding basis under regulation changes the amounts charged to General Fund balances. Regulations are varied and complex, resulting in a risk that management misstatement accounting adjustments to manipulate the General Fund balance. We have identified the risk to be highest for adjustments concerning the application of capital receipts. For the 2019/20 financial year capital receipts for the Council are expected to be material.

Overview of our 2019/20 audit strategy

Audit risks and areas of focus			
Risk / area of focus	**Risk identified**	**Change from PY**	**Details**
Valuation of market based property assets (including Property, plant and equipment, Council Dwellings and Investment Properties)	Significant Risk	Increase in risk for 2019/20	The council has highly material market based property assets (including Property, plant and equipment, Council Dwellings and Investment Properties). The valuation of such assets is a significant accounting estimate that, in the context of an uncertain economic environment as a result of COVID-19, has a material impact on the financial statements. Therefore, as a result of COVID-19 this risk has increased from an inherent risk to a significant risk. The Council engages property valuation specialists to determine asset valuations. Small changes in assumptions when valuing these assets can have a material impact on the financial statements. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.
Group Financial Statements: Valuation of Queensway Asset	Significant Risk	No change in risk or focus	The valuation of the Queensway asset is material to the Council's group financial statements. This asset is a regeneration asset with commercial activities in Stevenage town centre that was undergoing regeneration as of 31 March 2020. The valuation of this asset is based on future expected cash flows that Queensway LLP will receive from its tenants. As the asset is undergoing regeneration, and the uncertain economic environment as a result of the COVID-19 pandemic, there are an increased number of assumptions and estimates that underpin the valuation of this asset. As such the valuation of this asset in particular is susceptible to material misstatement.
Valuation of property, plant and equipment assets under depreciated replacement cost model	Inherent risk	No change in risk or focus	Property, plant and equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet. For assets valued using depreciated replacement cost (DRC) this risk is heightened due to the specialised nature of the assets and insufficient availability of market-based evidence to assist the valuation. As the Council's DRC asset base is significant, and the outputs from the valuer are subject to estimation, there is an inherent risk that PPE may be under/overstated or the associated accounting entries incorrectly posted.

Overview of our 2019/20 audit strategy

Audit risks and areas of focus			
Risk / area of focus	**Risk identified**	**Change from PY**	**Details**
Preparation of Group Accounts	Inherent risk	Decrease in risk for 2019/20	Queensway LLP was formed by Stevenage Borough Council in November 2018 as an entity to facilitate the regeneration of the Queensway asset that is an integral part of the Council's town centre regeneration strategy. During the 2018/19 audit we considered the preparation of group accounts as a significant risk for the audit as it was the first time that Queensway LLP was consolidated into the group financial statements. There were no significant issuing arsing from the Council's group accounts consolidation, however as 2019/20 is the first full financial year for Queensway LLP we still consider the risk relating to the preparation of group accounts and our group audit procedures to be an inherent risk.
Queensway Lease Accounting Treatment	Inherent risk	Decrease in risk for 2019/20	In preparing Queensway LLP financial statements significant judgements are taken in relation to the lease accounting treatment. We reviewed these judgements during the 2018/19 audit and a number of amendments as a result of the audit were made to the group financial statements. As 2019/20 is the first full financial year for Queensway LLP we need to consider whether these judgements remain appropriate. We will engage EY Accounting Advisory Service specialists to obtain assurance over the accounting treatment for the lease arrangement for the 2019/20 audit.
Pension liability valuation	Inherent risk	No change in risk or focus	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. The Council's current pension fund deficit is a material and sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the Actuary. Accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions, in the current uncertain economic environment, we consider this to be a higher inherent risk. In addition, every three years, a formal valuation of the whole fund in carried out in accordance with the LGPS Regulations 2013 to assess and examine the ongoing financial position of the fund. The IAS19 report for 2019/20 will reflect the updated membership numbers provided for this triennial valuation. We will therefore need to seek additional assurances from the Pension Fund auditor over this data.

Overview of our 2019/20 audit strategy

Audit risks and areas of focus			
Risk / area of focus	**Risk identified**	**Change from PY**	**Details**
Recognition of grant income associated with Covid-19	Inherent risk	New risk for 2019/20	The Council has received additional funding in the form of grants as a result of the Covid-19. There is the potential for the recognition and treatment of these grants (including business rate related grants) to be manipulated to improve the reported position. We will consider the elements of grant income, their susceptibility to manipulation and the appropriate audit response.
Going Concern Disclosures	Inherent risk	New risk for 2019/20	This Going Concern auditing standard (ISA 570) has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after. The revised standard extends requirements to report to regulators where we have concerns about going concern. In particular for the 2019/20 audit we will undertake sufficient and appropriate audit procedures to review the adequacy of management's disclosures, assumptions and stress testing on their assessment of going concern in response to Covid-19. For Stevenage Borough Council the risk of material uncertainties in relation to going concern has increased due to the increased financial pressures that the Council is facing as a result of the Covid-19 pandemic.

Overview of our 2019/20 audit strategy

Materiality

Planning materiality

£1.11m

Materiality for the Council's financial statements has been set at £1.11 million, which represents 1.0% of the prior years gross expenditure of the Council. In the prior year we applied a threshold of 2% of gross expenditure. We have judged it appropriate to adopt a lower level of materiality based on the changes to the risk profile that we have identified for the Council and its business. In addition, this lower level of materiality is deemed appropriate due to the challenging financial position that the Council faces as a result of Covid-19 and the Council higher public interest and profile associated with this.

The impact of setting planning materiality at 1% of gross expenditure, compared to 2% in the prior year, will directly impact the extent of audit procedures and audit sampling conducted throughout the audit.

Performance materiality

£833k

Performance materiality represents 75% of planning materiality, consistent year on year. We will revisit the appropriateness of this level when we receive the draft financial statements. This will take account of our assessment of the control environment for the preparation of the accounts and supporting working papers as a result of social distancing measures introduced and those which remain in force during the course of the audit in response to Covid-19.

Audit differences

£55.5k

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, housing revenue account, and collection fund) greater than £55,500. We will communicate other misstatements identified to the extent that they merit the attention of the Audit Committee. This level is driven by our calculation of planning materiality and will change if this is revised during the course of the audit.

Overview of our 2019/20 audit strategy

Audit scope

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

- Our audit opinion on whether the Stevenage Borough Council and Group financial statements give a true and fair view of the financial position as at 31 March 2020 and of the income and expenditure for the year then ended; and

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

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

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

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

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

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

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 15 in recent years as well as the expansion of factors impacting the value for money conclusion. Therefore to the extent any of these or any other risks are relevant in the context of Stevenage Borough Council audit, we will discuss these with management as to the impact on the scale fee.

02 Audit risks

Our response to significant risks

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

Management override Misstatements due to fraud or error (Fraud Risk)	What is the risk?	What will we do?

	The financial statements as a whole are not free of material misstatements whether caused by fraud or error.
	
	As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.
		• Identify fraud risks during the planning stages.
		• Inquire of management about risks of fraud and the controls put in place to address those risks.
		• Understand the oversight given by those charged with governance of management's processes over fraud.
		• Consider the effectiveness of management's controls designed to address the risk of fraud.
		• Determine an appropriate strategy to address those identified risks of fraud.
		• Perform mandatory procedures regardless of specifically identified fraud risks, including:
		    • testing of journal entries and other adjustments in the preparation of the financial statements.
		    • assessing accounting estimates for evidence of management bias; and
		    • evaluating the business rationale for significant and unusual transactions.

Our response to significant risks

Incorrect capitalisation of revenue expenditure

(Fraud Risk)

Financial statement impact

Misstatements that occur in relation to capitalisation of revenue expenditure could affect the comprehensive income and expenditure account and the balance sheet by decreasing revenue expenditure and increasing capital expenditure.

Amounts reported in the 2018/19 financial statements were:

Capital additions (reported in Note 13) £40.8 million

What is the risk?

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

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

A key way of improving the revenue position is through the inappropriate capitalisation of revenue expenditure. The Council has a significant fixed asset base and a material capital programme and therefore has the potential to materially impact the revenue position through inappropriate capitalisation

What will we do?

We will take a substantive approach to respond to the specific risk, undertaking the following procedures related to the incorrect capitalisation of revenue expenditure:

- Test a sample of capital expenditure at a lower testing threshold to verify that revenue costs have not been inappropriately capitalised;
- Our testing will examine invoices, capital expenditure authorisations, leases and other data that support capital additions. We will review the sample selected against the definition of capital expenditure in IAS16.
- As part of our journal testing strategy, we will review unusual journal pairings related to capital expenditure posted around the year-end i.e. where the debit is to capital expenditure and the credit to income and expenditure.

Our response to significant risks (continued)

Misclassification of capital receipts as revenue (Fraud Risk)

Financial statement impact

We have identified a specific risk of misstatements due to fraud or error that could affect the income and expenditure accounts and the balance sheet.

We consider the risk applies to the application of capital receipts in the comprehensive income and expenditure statement (CIES) and balance sheet (via the capital financing requirement).

In 2018/19 the Council applied £9.5 million of capital receipts funding in the Capital Financing Requirement note of the accounts.

What is the risk?

The Council is under significant financial pressure to achieve its revenue budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way of achieving these targets.

We consider the risk applies to the application and use of capital receipts in the financial statements.

The adjustments between accounting basis and funding basis under regulation changes the amounts charged to General Fund balances. Regulations are varied and complex, resulting in a risk that management misstatement accounting adjustments to manipulate the General Fund balance. We have identified the risk to be higher for adjustments concerning the application of useable capital receipts and deferred capital receipts.

What will we do?

Our approach will focus on:

- Sample testing the application of capital receipts in the capital financing requirement to ensure they meet the definition of sources of funding;
- Sample testing deferred capital receipts to ensure any conditions have been correctly applied; and
- Using our data analytics tool to identify and test journal entries adjustments that impact capital receipts.

Our response to significant risks (continued)

Valuation of market based property assets

(Significant Risk)

Financial statement impact

Misstatements that occur in relation to the valuation of market based property assets could affect the balance sheet by materially misstating the valuation of these assets; and the income and expenditure account via the impact on depreciation charges.

Amounts reported in the 2018/19 financial statements were:

Land and buildings (per Note 13): £94 million; Council Dwellings £619 million. Investment Properties (as per Note 14) £ 25 million.

What is the risk?

The council has highly material market based property assets (including Property, plant and equipment, Council Dwellings and Investment Properties). The valuation of such assets is a significant accounting estimate that, in the context of an uncertain economic environment as a result of COVID-19, has a material impact on the financial statements.

The Council engages property valuation specialists to determine asset valuations and small changes in assumptions when valuing these assets can have a material impact on the financial statements.

ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.

What will we do?

We will take a substantive approach to respond to the specific risk, undertaking the following procedures related to the valuation of property:

- Testing that assets have been classified and valued on an appropriate basis.
- Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- Sample testing and challenging the key asset information and assumptions used by the valuers in performing their valuation; for example floor plans based on price per square metre.
- Considering the annual cycle of valuations to ensure that assets have been valued within an appropriate timescale.
- Considering any specific changes to assets that have occurred and that these have been communicated to the valuer;
- Reviewing assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated;
- Considering changes to useful economic lives as a result of the most recent valuation; and
- Testing accounting entries have been correctly processed in the financial statements.

We will be engaging EY valuation specialists to assist the audit team on a sample of assets, based on our assessment of the asset valuations subject to a higher degree of risk for their valuations as at 31 March 2020.

We will also consider how the Council's valuer has addressed the impact of Covid-19 in the year-end valuation of assets and assessment of impairments.

Our response to significant risks (continued)

Group Financial Statements: Valuation of Queensway Asset

(Significant Risk)

Financial statement impact

The Queensway asset is recognised on the balance sheet of the Council's group financial statements. Any misstatements that occur in relation to the valuation this asset could affect the balance sheet by materially misstating the valuation of this asset; and the income and expenditure account via the impact on depreciation charges. There is no impact of general fund balances.

The valuation of this asset reported in the 2018/19 group financial statements was £11.875 million.

What is the risk?

The valuation of the Queensway asset is material to the Council's group financial statements. This asset is a regeneration asset with commercial activities in Stevenage town centre that was undergoing regeneration as of 31 March 2020. The valuation of this asset is based on future expected cash flows that Queensway LLP will receive from its tenants. As the asset is undergoing regeneration, and the uncertain economic environment as a result of the COVID-19 pandemic, there are an increased number of assumptions and estimates that underpin the valuation of this asset. As such the valuation of this asset in particular is susceptible to material misstatement.

The Council engages property valuation specialists to determine asset valuations and small changes in assumptions when valuing these assets can have a material impact on the financial statements.

ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.

What will we do?

We will take a substantive approach to respond to the specific risk, undertaking the following procedures related to the valuation of property:

- Testing that assets have been classified and valued on an appropriate basis.
- Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- Testing and challenging the key asset information and assumptions used by the valuers in performing their valuation; for example referencing tenancy schedules back to tenancy agreements;
- Considering any specific changes to assets that have occurred and that these have been communicated to the valuer;
- Testing accounting entries have been correctly processed in the financial statements.

Similar to the approach adopted in the prior year audit, we will again be engaging EY valuation specialists to assist the audit team to review the valuation of this asset.

We will also consider how the Council's valuer has addressed the impact of Covid-19 in the year-end valuation of assets and assessment of impairments.

Inherent Risks and Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures.

What is the risk/area of focus?	What will we do?
Valuation of property, plant and equipment assets under depreciated replacement cost model Property, plant and equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet. For assets valued using depreciated replacement cost (DRC) this risk is heightened due to the specialised nature of the assets and insufficient availability of market-based evidence to assist the valuation. As the Council's DRC asset base is significant, and the outputs from the valuer are subject to estimation, there is a significant risk PPE may be under/overstated or the associated accounting entries incorrectly posted.	We will: • Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support gross internal areas); • Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer; • Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated; • Consider changes to useful economic lives as a result of the most recent valuation; and • Test accounting entries have been correctly processed in the financial statements. It is likely that we will be engaging EY Valuation specialists to review a sample of DRC asset valuations.

Inherent Risks and Other areas of audit focus (cont.)

What is the risk/area of focus?	What will we do?
Preparation of Group Accounts Queensway LLP was formed by Stevenage Borough Council in November 2018 as an entity to facilitate the regeneration of the Queensway asset that is an integral part of the Council's town centre regeneration strategy. During the 2018/19 audit we considered the preparation of group accounts as a significant risk for the audit as it was the first time that Queensway LLP was consolidated into the group financial statements. There were no significant issuing arsing from the Council's group accounts consolidation, however as 2019/20 is the first full financial year for Queensway LLP we still consider the risk relating to the preparation of group accounts and our group audit procedures to be an inherent risk.	We will: • Enquire with management to understand the processes and controls in place for how intra-group transactions and balances are identified. • Substantively test the group the consolidation schedule to review whether the adjustments made are consistent with our knowledge gained throughout the audit of the Stevenage Borough Council and of Queensway LLP. • Review the group financial statements and consolidation schedule to consider whether the adjustments made are compliant with the applicable accounting standards, including IFRS 10 Consolidated Financial Statements and the CIPFA Code of Practice.
Queensway Lease Accounting Treatment In preparing Queensway LLP financial statements significant judgements are taken in relation to the lease accounting treatment. We reviewed these judgements during the 2018/19 audit and a number of amendments as a result of the audit were made to the group financial statements. As 2019/20 is the first full financial year for Queensway LLP we need to consider whether these judgements remain appropriate. We will engage EY financial reporting specialists to obtain assurance over the accounting treatment for the lease arrangement for the 2019/20 audit.	We will: • Review the lease accounting treatment adopted during 2019/20; including follow up on points identified during the 2018/19 review of the lease accounting treatment. In particular the interest rates applied to the leasing and borrowing elements of the lease agreement. • Consider whether the appropriate accounting journal entries are consistent with the prevailing accounting standard IAS 17 Leases. • Review the relevant lease disclosures in the Council's financial statements. We will engage EY financial reporting specialists to assist the audit team in reviewing the accounting treatment adopted.

Inherent Risks and Other areas of audit focus (cont.)

What is the risk/area of focus?	What will we do?
Pension liability valuation and disclosures The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. The Council's current pension fund deficit is a material and sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31st March 2019 this totalled £59 million. The information disclosed is based on the IAS 19 report issued to the Council by the Actuary. Accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions, in the current uncertain economic environment, we consider this to be a higher inherent risk. In addition, every three years, a formal valuation of the whole fund in carried out in accordance with the LGPS Regulations 2013 to assess and examine the ongoing financial position of the fund. The IAS19 report for 2019/20 will reflect the updated membership numbers provided for this triennial valuation. We will therefore need to seek additional assurances from the Pension Fund auditor over this data. An additional consideration in 2019/20 will be the impact of Covid-19 on the valuation of complex (Level 3) investments held by Hertfordshire Pension Fund, for example private equity investments where valuations as at 31 March 2020 will have to be estimated. This is likely to impact on the IAS19 reports provided by the actuary and the assurances over asset values that are provided by the pension fund auditor, and consequently the assurance we are able to obtain over the net pension liability in the Council's accounts.	We will: • Liaise with the auditors of Hertfordshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Stevenage Borough Council; • Assess the work of the Pension Fund actuary including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and • Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. • Assess the results of the triennial valuations, including the assumptions used and the impact on the Council's pension liability. • Engage early with the Council, and their actuary, to understand any ongoing impact of the McCloud judgement and GMP rulings on the IAS19 liability. • Consider the nature and value of level 3 investments held by Hertfordshire Pension Fund and the proportion of the overall Fund relating to Stevenage Borough Council in order to identify any additional procedures required to support the estimates of the valuation of these asset as at 31 March 2020.

Inherent Risks and Other areas of audit focus (cont.)

What is the risk/area of focus?	What will we do?
Recognition of grant income associated with Covid-19 The Council has received additional funding in the form of grants as a result of the Covid-19. There is the potential for the recognition and treatment of these grants (including business rate related grants) to be manipulated to improve the reported position.	We will: • Consider the revenue and capital grants received by the Council; • Assess the potential for manipulation of individual grant streams (including those related to business rates); and • Responsive to the risk, carry out testing to ensure the accounting treatment and recognition applied to grant income is appropriate.

Inherent Risks and Other areas of audit focus (cont.)

What is the risk/area of focus?	What will we do?
Going concern disclosures Covid-19 has created a number of financial pressures throughout Local Government. For Stevenage Borough Council the estimated financial pressure for the Council over an initial 6 month period is estimated to be £6.1 million. This includes significant reductions in income for the Council from car parks, business rate gains and other income; as well as additional cost pressures to accommodate the homeless. There is currently not a clear statement of financial support from MHCLG that covers all financial consequences of Covid-19. There have been a number of media stories in both the national press and trade publications raising the possibilities of an increase in Chief Financial Officers using their s114 powers. This could be under s114(3), insufficient resources to fund likely expenditure. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements. The auditor's report in respect of going concern covers a 12-month period from the date of the report, therefore the Council's assessment will also need to cover this period.	In light of the unprecedented nature of Covid-19, its impact on the funding of public sector entities and uncertainty over the form and extent of government support, we will be seeking a documented and detailed consideration to support management's assertion regarding the going concern basis and particularly with a view whether there are any material uncertainties for disclosure. We will review your updated going concern disclosures within the financial statements under IAS1, and associated financial viability disclosures within the Narrative Statement. We expect you to disclose any material uncertainties that do exist. These disclosures should also include the process that has been undertaken for revising financial plans and cashflow, liquidity forecasts, known outcomes, sensitivities, mitigating actions including but not restricted to the use of reserves, and key assumptions (e.g. assumed duration of Covid-19). Our audit procedures to review these will include consideration of: • Current and developing environment; • Liquidity (operational and funding); • Mitigating factors; • Management information and forecasting; and • Sensitivities and stress testing. We will also consider the implications of any material uncertainties and/or heightened risks of the CFO exercising s114 powers for our audit reporting and any exercise of our statutory audit powers throughout the course of the audit.

Other areas of audit focus

Impact of Covid-19

The ongoing disruption to daily life and the economy as a result of the Covid-19 virus will have a pervasive impact upon the financial statements. Understandably, the priority for the Council to date has been to ensure the safety of staff and the delivery of business critical activities. However, the financial statements will need to reflect the impact of Covid-19 on the Council's financial position and performance. Due to the significant uncertainty about the duration and extent of disruption, at this stage we have not identified specific risks related to Covid-19, but wish to highlight the wide range of ways in which it could impact the financial statements. In addition to our comments on going concern at page 22, these may also include, but not be limited to:

- Revenue recognition – there may be an impact on income collection (council tax and business rates) if businesses and residents are unable to work and earn income due to the lockdown and restriction of movement due to COVID-19.
- Tangible assets – there may be impairment of tangible assets if future service potential is reduced by the economic impact of the virus. The Council may also have already incurred capital costs on projects where the economic case has fundamentally changed.
- Pensions – volatility in the financial markets is likely to have a significant impact on pension assets, and therefore net liabilities.
- Receivables – there may be an increase in amounts written off as irrecoverable and impairment of year-end balances due to the increased number of businesses and residents unable to meet their financial obligations.
- Holiday and sickness pay – the change in working patterns may result in year-end staff pay accruals which are noticeably different to prior years.
- Government support – any Covid-19 specific government support is likely to be a new transaction stream and may require development of new accounting policies and treatments.
- Annual Governance Statement– the widespread use of home working is likely to change the way internal controls operate. The Annual Governance Statement will need to capture how the control environment has changed during the period up to the date of approval of the accounts and what steps were taken to maintain a robust control environment during the disruption. This will also need to be considered in the context of internal audit's ability to issue their Head of Internal Audit opinion for the year, depending on the ability to complete the remainder of the internal audit programme where this is not yet complete.

We will provide an update on the impact of Covid-19 on the Council's financial statements, and how we have responded to the additional risks of misstatement, later in our audit.

In addition to the impact on the financial statements themselves, the disruption caused by Covid-19 may impact on management's ability to produce the financial statements and our ability to complete the audit to the planned timetable. For example, it may be more difficult than usual to access the supporting documentation necessary to support our audit procedures. There will be additional audit procedures we have to perform to respond to the additional risks caused by the factors noted above.

03 Value for Money Risks

Value for Money

Background

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

For 2019/20 this is based on the overall evaluation criterion:

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

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

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

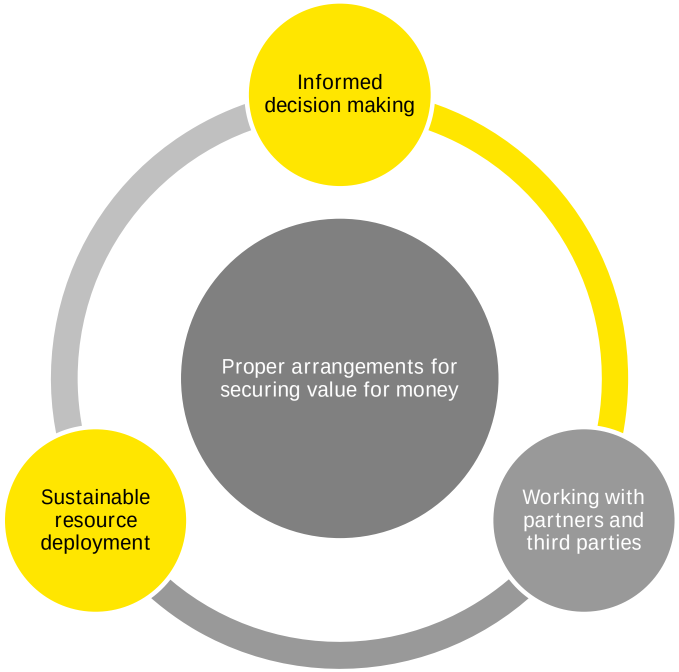
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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

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

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2019/20, this has included consideration of the steps taken by the Council to consider the impact of Brexit and Covid-19 on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Councils will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

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



Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Financial resilience The Council is operating in a challenging financial environment with reduced income and increased costs pressures as a result of Covid-19. The Council has estimated this increased financial pressure to be £6.1 million for the initial 6 month period; however given the unprecedented circumstances there is significant uncertainty surrounding the type and duration of social distancing measures that will be in place as a result of Covid-19, and the resulting financial impact this has on the Council. The September 2019 Medium Term Financial Strategy (MTFS) identified £1.9 million of Financial Security targets to be achieved by 2022/23; as well as an additional increase of the saving targets of £135,000 which is yet to be identified (effectively a budget gap). Delivery of the Financial Security Targets is critical for the Council to sustainably deploy its resources in the medium term. This represents a significant risk to the Council's overall financial resilience. Stevenage Borough Council has a lower level of reserves available to it compared to other local authorities in Hertfordshire. This is due to the Council's planned use of resources over the medium term as set out in their MTFS. The Council risk assesses its required minimum level of reserves for both the general fund and the housing revenue account. The Council will be revisiting its budget and MTFS assumptions in light of Covid-19. The Council's revised MTFS will be presented at the June 2020 Executive meeting.	Deploy resources in a sustainable manner	Our approach will focus on: • Identify the key assumptions contained in the medium-term financial plan and the reasonableness of the basis of these; • Review the Council's stress testing of these assumptions; sensitivity analysis and mitigating actions. • Developing an understanding of how the Council identifies its budget gaps and risk mitigations; • Assess the Council's track record on delivering savings and the robustness of its future savings plans. • Review the process by which the Council risk assesses its minimum required level of reserves. • Stress test the Council's financial resilience and adequacy of available reserves and balances before and in light of Covid-19. This will also link to the work we need to do on going concern set out on page 22 and whether this indicates any underlying concerns with the Council's arrangements to secure its financial resilience in the 2019/20 financial year.

04 Audit materiality

Materiality

Materiality

Materiality for the Council's financial statements has been set at £1.11 million, which represents 1.0% of the prior years gross expenditure of the Council. In the prior year we applied a threshold of 2% of gross expenditure. We have judged it appropriate to adopt a lower level of materiality based on the changes to the risk profile that we have identified for the Council and its business. In addition, this lower level of materiality is deemed appropriate due to the challenging financial position that the Council faces as a result of Covid-19 and the Council higher public interest and profile associated with this.

We have provided additional information about audit materiality in Appendix C.

Expenditure for Materiality purpose
£111.11m

Planning materiality
£1.11m

Performance materiality
£833k

Audit differences
£55,500

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

Key definitions

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

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £833k which represents 75% of planning materiality. We have considered a number of factors such as the number of errors in the prior year and any significant changes when determining the percentage of performance materiality. We have used the higher end of the range.

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

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

Specific materiality – We have set a lower materiality for Senior Officer's Remuneration, Members' Allowances and Exit Packages disclosures which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this.

Group materiality – We will update the Committee at the next available opportunity about the materiality level we have used in the audit of the group accounts. Given the size of Queensway LLP this is unlikely to be significantly different from the values presented here.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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

We issue an audit report that covers:

1. Financial statement audit

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

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

Procedures required by standards

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

Procedures required by the Code

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

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

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

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

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

For 2019/20 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

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

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

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

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

Scope of our audit

Scoping the group audit

Group scoping

Our audit strategy for performing an audit of an entity with multiple locations is risk based. We identify components as either:

1. Significant components: A component is significant when it is likely to include risks of material misstatement of the group financial statements, either because of its relative financial size to the group (quantitative criteria), or because of its specific nature or circumstances (qualitative criteria). We generally assign significant components a full or specific scope given their importance to the financial statements.
2. Not significant components: The number of additional components and extent of procedures performed depended primarily on: evidence from significant components, the effectiveness of group wide controls and the results of analytical procedures.

Stevenage Borough Council has control of Queensway LLP through a partnership with Marshgate Ltd (a subsidiary holding company that the Council owns). Marshgate Ltd is not consolidated into the Council's group financial statements on the grounds of materiality. Queensway LLP is consolidated into the Council's group financial statements. For the purpose of the group audit we have consider Queensway LLP to be a significant component and have designated it a 'specific' scope. This is approach is consistent with that adopted in the prior year.

Scope definitions

Full scope: locations where a full audit is performed to the materiality levels assigned by the Group audit team for purposes of the consolidated audit. Procedures performed at full scope locations support an interoffice conclusion on the reporting package. These may not be sufficient to issue a stand-alone audit opinion on the local statutory financial statements because of the materiality used and any additional procedures required to comply with local laws and regulations.

Specific scope: locations where the audit is limited to specific accounts or disclosures identified by the Group audit team based on the size and/or risk profile of those accounts.

Review scope: locations where procedures primarily consist of analytical procedures and inquiries of management. On-site or desk top reviews may be performed, according to our assessment of risk and the availability of information centrally.

Specified Procedures: locations where the component team performs procedures specified by the Group audit team in order to respond to a risk identified.

Other procedures: For those locations that we do not consider material to the Group financial statements in terms of size relative to the Group and risk, we perform other procedures to confirm that there is no risk of material misstatement within those locations.

Details of specified and other procedures

- Based on a review of Queensway LLP's prior period financial data at the planning stage of the audit we consider the following areas to for this component to be included within the specific scope of the group audit:
  - Property – Land & Buildings
  - Cash
  - Finance Lease Liability
  - Long Term Borrowing

- As 2019/20 will be the first full year that Queensway LLP accounts will be consolidated into the Council's group financial statements, the scope of the Queensway LLP component may change based on its outturn and draft accounts for the year end 31 March 2020. If we identify any changes in scope of the group audit we will communicate these at the next Audit Committee.

Scoping the group audit (continued)

Group audit team involvement in component audits

Queensway LLP is yet to appoint its own external auditors. If external auditors for Queensway LLP are appointed, and Queensway LLP's audit is completed in an agreeable timeframe, then we may place some reliance on the audit procedures performed by Queensway LLP's auditors (component auditors) to support our group financial statements opinion for the year end 31 March 2020. Auditing standards require us to be involved in the work of component auditor teams. We envisage this will take the form of issuing group audit instructions and other communications and meetings with the component audit team throughout the audit.

However, if we are not able to place reliance on assurance provided by a component audit team then we would be required to conduct the audit procedures ourselves to gain assurance over the transactions and balances that are consolidated into the Council's group financial statements.

Other planned group audit procedures to be performed by the primary audit team (EY) include:

- Analytical review of actual performance compared to budget, prior year and KPIs by location.
- Review of group wide entity level controls over these components, including the level of CEO, CFO and other group management oversight.
- Test consolidation journals, intercompany eliminations and foreign currency translation recalculations.
- Enquiry of management about unusual transactions in these components.
- Review of management's reconciliation of local statutory accounts to prior year group reporting packages.

06 Audit team

Audit team

Audit team structure:

Neil Harris
Associate Partner

Robert Garnett
Manager

Clement Odeh
Senior

Specialists

- EY Financial Accounting Advisory Service
- EY Valuations team
- EY actuaries

Use of specialists

- Our approach to the involvement of specialists, and the use of their work.

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

Area	Specialists
Valuation of Land and Buildings	EY Valuations Team
Lease accounting treatment	EY Financial Accounting Advisory Service
Pensions disclosure	EY Actuaries

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

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

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

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2019/20.

From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Audit Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

The disruption caused by Covid-19 may impact on management's ability to produce the financial statements and our ability to complete the audit to the planned timetable. For example, it may be more difficult than usual to access the supporting documentation necessary to support our audit procedures. There will be additional audit procedures we have to perform to respond to the additional risks caused by the factors noted above. The timetable below is therefore provisional and will need to be revisited throughout the period. We will discuss any potential delays to the timetable with officers and the Audit Committee Chair. In recognition of this, MHCLG have provided flexibility to Local Government bodies on the timetable for the preparation of draft accounts (by the end of August 2020), the public inspection period (by September 2020) and the target date for publication of audited financial statements (by end of November 2020).

At the moment, the Council are working towards preparing draft accounts and supporting working papers for the audit to commence from the beginning of August 2020. We currently anticipate concluding the audit in September 2020, and thereafter reporting the results of the audit to this Audit Committee. However, this timetable is subject to change pending on the progress of the audit.

Audit phase	Timetable	Audit Committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	March		
Walkthrough of key systems and processes	March/April	June 2020	Audit Planning Report
Year end audit	August/September		
Audit Completion procedures	September	September/October 2020	Audit Results Report Audit opinions and completion certificates
Conclusion of reporting	September /October 2020	September/October 2020	Annual Audit Letter

08 Independence

Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
▸ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between you, your affiliates and directors and us; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence. ▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard.	▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▸ Written confirmation that all covered persons are independent; ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements , the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

Relationships, services and related threats and safeguards

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

Overall Assessment

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

Self interest threats

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

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, the current ratio of non-audit fees to audit fees is 32%. The non-audit fees for Stevenage Borough Council are solely due to Housing Benefit Certification procedures that the Council engages EY to perform. Given the nature of the certification procedures and that the fee is agreed upfront, we consider that no additional safeguards are required.

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

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

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

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

Management threats

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

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

Relationships, services and related threats and safeguards

Other threats

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

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

New UK Independence Standards

The Financial Reporting Council (FRC) published the Revised Ethical Standard 2019 in December and it will apply to accounting periods starting on or after 15 March 2020. A key change in the new Ethical Standard will be a general prohibition on the provision of non-audit services by the auditor (and its network) which will apply to UK Public Interest Entities (PIEs). A narrow list of permitted services will continue to be allowed.

Summary of key changes

- Extraterritorial application of the FRC Ethical Standard to UK PIE and its worldwide affiliates
- A general prohibition on the provision of non-audit services by the auditor (or its network) to a UK PIE, its UK parent and worldwide subsidiaries
- A narrow list of permitted services where closely related to the audit and/or required by law or regulation
- Absolute prohibition on the following relationships applicable to UK PIE and its affiliates including material significant investees/investors:
    - Tax advocacy services
    - Remuneration advisory services
    - Internal audit services
    - Secondment/loan staff arrangements
- An absolute prohibition on contingent fees.
- Requirement to meet the higher standard for business relationships i.e. business relationships between the audit firm and the audit client will only be permitted if it is inconsequential.
- Permitted services required by law or regulation will not be subject to the 70% fee cap.
- Grandfathering will apply for otherwise prohibited non-audit services that are open at 15 March 2020 such that the engagement may continue until completed in accordance with the original engagement terms.
- A requirement for the auditor to notify the Audit Committee where the audit fee might compromise perceived independence and the appropriate safeguards.
- A requirement to report to the Audit Committee details of any breaches of the Ethical Standard and any actions taken by the firm to address any threats to independence. A requirement for non-network component firm whose work is used in the group audit engagement to comply with the same independence standard as the group auditor. Our current understanding is that the requirement to follow UK independence rules is limited to the component firm issuing the audit report and not to its network. This is subject to clarification with the FRC.

Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under FRC Revised Ethical Standard 2016 which will continue to apply until 31 March 2020 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 1 April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.

We do not provide any non-audit services which would be prohibited under the new standard.

Other communications

EY Transparency Report 2019

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

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year end 30 June 2019:

https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2019/ey-uk-2019-transparency-report.pdf

09 Appendices

Appendix A

Fees

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

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

	Planned fee 2019/20	Scale fee 2019/20	Final Fee 2018/19
	£	£	£
Total Fee – Code work	TBC***	49,283	76,283*
Other non-audit services not covered above (Housing Benefits)	TBC	TBC	24,400**
Total fees	£	£	£100,683

All fees exclude VAT

*The scale fee for 2018/19 was £49,283. The fee shown above includes the additional procedures required to respond to the identified additional risks that were not included within the base scale fee. These include:
- Increase in scope of audit as group financial statements were prepared (on going for 19/20)
- Risk related to preparation of group financial statements (on going for 19/20)
- Risk related to significant judgements for Queensway LLP (on going for 19/20)
- Risks related to value for money conclusion.
- Additional time taken to review corrections made to the Property, Plant and Equipment disclosure note.

We estimate our additional fee to be £27,000. We have yet to agree the proposed additional fee with officers and is subject to PSAA approval.

** The 2018/19 base fee was £7,600, the incremental fee relates to the 7 sets of extended testing carried out in response to a number of identified errors.

*** For 2019/20 we do not believe the existing scale fees provide a clear link between a public sector organisation's risk and complexity and the increased regulatory requirements to deliver an ISA compliant audit. Further background and context of the audit fee for 2019/20 is set out on the next two pages.

We have discussed this context and the fee implications for 2019/20 as we see them with the Strategic Director (CFO). Based on the risk profile for Stevenage Borough Council, as outlined in the Audit Risk section of this report, we have estimated the indicative fee for the 2019/20 to be between £120,000 and £150,000. In light of the changes to the risk profile of the Council and the implications on our audit procedures, we will update the CFO on the final proposed fee we will be submitting to PSAA to determine. We will update the Audit Committee on this level ahead of our audit results reporting later this year.

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

Any agreed fee is presented based on the following assumptions:

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

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

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

Appendix A

Fees

We do not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity. For an organisation such as the Council the extent of audit procedures now required mean it will take 1400-1500 hours to complete a quality audit.

Summary of key factors

1. Status of sector. Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, speculative ventures and investments. This has also brought increasing risk about the financial sustainability / going concern of bodies given the current status of the sector.

    - To address this risk our procedures now entail higher samples sizes of transactions, the need to increase our use of analytics data to test more transactions at a greater level of depth. This requires a continual investment in our data analytics tools and audit technology to enhance audit quality. This also has an impact on local government with the need to also keep pace with technological advancement in data management and processing for audit.

2. Audit of estimates. There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.

    - To address these findings, our required procedures now entail higher samples sizes, increased requirements for corroborative evidence to support the assumptions and use of our internal specialists.

3. Regulatory environment. Other pressures come from the changing regulatory landscape and audit market dynamics:

    - Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.

    - This means continual investment in our audit quality infrastructure in response to these regulatory reviews, the increasing fines for not meeting the requirements plus changes in auditing and accounting standards. As a firm our compliance costs have now doubled as a proportion of revenue in the last five years. The regulatory lens on Local Audit specifically, is greater. We are three times more likely to be reviewed by a quality regulator than other audits, again increasing our compliance costs of being within this market.

Appendix A

Fees

Summary of key factors (cont'd)

4. As a result Public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

   - We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality.

   - We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.

Next steps

- In light of recent communication from PSAA, we will need to quantify the impact of the above to be able to accurately re-assess what the baseline fee is for the Council should be in the current environment. Once this is done we will be able to discuss at a more detailed level with you.

Appendix B

Required communications with the Audit Committee

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

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report – June 2020
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Audit results report – Upon completion of the audit

Required communications with the Audit Committee (continued)

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

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Audit planning report – June 2020 Audit results report – Upon completion of the audit
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report – Upon completion of the audit
Consideration of laws and regulations	• Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit and Scrutiny Committee may be aware of	Audit results report – Upon completion of the audit
Internal controls	• Significant deficiencies in internal controls identified during the audit	Audit results report – Upon completion of the audit

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report – Upon completion of the audit
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report – Upon completion of the audit
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit results report – Upon completion of the audit
Fee Reporting	• Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Audit planning report – June 2020 Audit results report – Upon completion of the audit
Group audits	• An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work • Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Audit planning report – June 2020 Audit results report – Upon completion of the audit

Appendix C

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 1, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	• Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. • Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. • Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. • Concluding on the appropriateness of management's use of the going concern basis of accounting. • Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. • Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the Audit Committee reporting appropriately addresses matters communicated by us to the Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and • Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements. We will update the Audit Committee prior to our audit of the 2019/20 financial statements on our planned level of audit materiality. For the Authority, we typically base on our audit materiality on gross assets as opposed to service expenditure as we believe the Authority's stewardship of its assets influence the economic decisions of the users of the financial statements. We do set specific and lower testing thresholds to inform the level of work we perform on revenue transactions.

Materiality determines:

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

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