Stevenage Borough Council
Audit results report

Year ended 31 March 2020

February 2022

Building a better working world

17 February 2022

Dear Audit Committee Members

We are pleased to attach our audit results report for the forthcoming meeting of the Audit Committee. This report summarises our audit conclusion in relation to the audit of Stevenage Borough Council (the Authority) for 2019/20. We will issue our final report following the Audit Committee meeting on 28 February 2022.

The audit of the 2019/20 audit of Stevenage Borough Council has not been straight forward due to a number of reasons, including the impact of the Covid-19 pandemic both in terms of audit risks and our planned procedures to address those risks, but also practically conducting a remote audit. We acknowledge that the resourcing of our local government audits remains a challenge due to the shortage of staff within the local government audit market with the specific skills and knowledge required to conduct an effective audit. We have had to make tough decisions to delay the delivery of audits across all of our audited entities in order to safeguard audit quality. We would like to thank all of the Council's officers (both past and present) who participated in the audit.

We have substantially completed our audit of the Council for the year ended 31 March 2020. Our remaining procedures, which will be completed during February 2022, mainly consist of the completion of our quality assurance review procedures on the final assembly of audit working papers and routine consultation processes in relation to the Council's revised going concern disclosures. Subject to concluding the outstanding matters listed in our report, we confirm that we expect to issue an unqualified audit opinion on the financial statements in the form at Appendix C of this report, shortly following this committee. We expect to also issue an unmodified opinion in relation to the Council's value for money conclusion.

This report is intended solely for the use of the Audit Committee, other members of the Authority, and senior management. It should not be used for any other purpose or given to any other party without obtaining our written consent. We would like to thank your staff for their help during the engagement. We welcome the opportunity to discuss the contents of this report with you at the Audit Committee meeting on 28 February 2022.

Yours faithfully

Neil Harris
Associate Partner
For and on behalf of Ernst & Young LLP
Encl

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Public Sector Audit Appointments Ltd (PSAA) have issued a ‘Statement of responsibilities of auditors and audited bodies’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk). This 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 (updated April 2018)’ issued by 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 statute, and covers matters of practice and procedure which are of a recurring nature.

This Audit Results Report is prepared in the context of the Statement of responsibilities / Terms and Conditions of Engagement. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Hywel Ball, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

01 Executive Summary

Executive Summary

Status of the audit

We have substantially completed our audit of the Stevenage Borough Council financial statements for the year ended 31 March 2020 and have performed the procedures outlined in our Audit Plan.

The outstanding work at the date of this report is:

- Completion of remaining review procedures with respect to documentation on our audit file by the audit manager and engagement partner.
- The outcome of the internal consultation with EY's professional practice department on the appropriateness of the Council's going concern disclosure.
- Completion of subsequent events review, including update of our review of committee minutes.
- Final review and completion checks on the financial statements.
- Completion of audit conclusion procedures, in order to issue our audit report.
- Receipt of the signed management representation letter.

Subject to satisfactory completion of the following outstanding items above, we expect to issue an unqualified opinion on the Authority's financial statements in the form which appears at Appendix C.

Executive Summary

Scope update

In our Audit Plan dated 9 June 2020, we provided you with an overview of our audit scope and approach for the audit of the financial statements, including our assessment and planned response of risks arising from the Covid-19 pandemic on the financial statements. We carried out our audit in accordance with this plan, with the following exceptions:

- Timescale of the audit – The audit of the Council's 2019/20 financial statements has been protracted due to a number of reasons:
    - As communicated in our Audit Plan, increased audit risks as the result of the Covid-19 pandemic.
    - As communicated in our Audit Plan, increased audit testing due to the reduced materiality compared to the prior year 2018/19 audit.
    - Turnover of the Council's key financial personnel multiple times throughout the audit period has increased the time taken to resolve audit queries and agree on amendments to the financial statements.
    - The number of audit misstatements identified, and also the complexity of adjustments to the financial statements. In particular the accounting treatment adopted for Local Enterprise Partnership (LEP) funding as grant income in the draft financial statements.
    - The current state of the local government audit sector, including increased quality demands from the FRC (as the audit regulator) and the challenge of clearing delayed audits across the sector.

  Materiality

  We updated our planning materiality assessment using the 2019/20 draft statement of accounts. Based on our materiality measure of 1% of gross expenditure on the provision of services, we have updated our overall materiality assessment to £1.05 million (Audit Plan – £1.11 million). This results in updated performance materiality, at 75% of our overall planning materiality, of £0.792 million, and an updated threshold for reporting misstatements of £52,777 (5% of Planning Materiality).

- Information Produced by the Entity (IPE) – We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We undertook the following to address this risk:
    - Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and
    - Agree IPE to scanned documents or other system screenshots.

As disclosed in the audit plan, additional risks are likely to result in additional audit fees which will be discussed with S151 officer and then submitted to PSAA for determination. Refer to section 7 of this report for more information on the audit fee.

Executive Summary

Audit differences

Unadjusted audit differences

We have identified 3 audit differences which have not been adjusted for by management in the 2019/20 statement of accounts. Overall these are not material the financial statements, however, we are required to report all unadjusted audit differences above £53k to the Audit Committee.

The unadjusted audit differences relate to:
- Inappropriate capitalisation of revenue expenditure, £153k.
- Valuation of property, plant and equipment, £120k.
- Queensway lease accounting treatment, £175k.

We will seek representations from management in the management letter of representation for all unadjusted audit differences.

Adjusted audit differences

During the audit identified 9 audit differences which have been adjusted for by management in the 2019/20 statement of accounts. The most of significant of which relate to the accounting treatment of LEP funding, the valuation of pension liability and the valuation of the Council's property assets.

In addition, various disclosure differences have been amended for. The most significant of which was to correct multiple financial statement disclosures for internal consistency with other financial statement disclosures.

Refer to section 3 of this report for further information on audit differences.

Other reporting issues

We have reviewed the information presented in the Annual Governance Statement for consistency with our knowledge of the Authority. The Annual Governance Statement has been updated to reflect the impact of the Covid-19 pandemic on the Council's arrangements. We have no matters to report as a result of this work.

Procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission for 2019/20 are no longer required based on the current timetable of the 2019/20 Whole of Government Accounts.

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Authority to consider it or to bring it to the attention of the public (i.e. "a report in the public interest"). We also have a duty to make written recommendations to the Authority, copied to the Secretary of State, and take action in accordance with our responsibilities under the Local Audit and Accountability Act 2014. We did not identify any issues.

Other reporting matters

As the result of the audit we have a number of observations and recommendations for the Council relating to the capacity and resilience of the Council's finance team, as well as the processes in place to be prepared for an audit. Please refer to section 5 of this report for the detail observations and our recommendations for the Council.

Executive Summary

Audit Risk and Areas of audit focus

Our audit plan identified key areas of audit risk and areas of focus for our audit of the Authority's financial statements. We summarise below our findings for the significant risks of the audit:

Significant risk	Provisional findings & conclusions, subject to the final completion of our quality review procedures.
Misstatements due to fraud or error – Risk of management override	We have completed our planned audit procedures and found no indications of management override of controls.
Misstatements due to fraud or error – Inappropriate capitalisation of revenue expenditure	We have completed our planned audit procedures. Based on sample testing we have identified one projected misstatement of £153k in relation to inappropriate capitalisation of revenue expenditure. This audit difference has not been amended for by management.
Misstatements due to fraud or error – Misclassification of capital receipts as revenue	We have completed our planned audit procedures. We identified that the Council incorrectly accounted for £4.1m of Local Enterprise Partnership (LEP) funding as grant income when it should have recognised as a long term liability. This audit difference has been amended for by management.
Valuation of market based property assets (including Property, Plant and Equipment, Council Dwellings and Investment Properties)	We have completed our procedures including review of a sample of valuations by our EY Real Estates specialist. A number of audit misstatements were identified as the result of procedures performed. Audit difference of £1.07m have been corrected for by management, however, the net impact of unadjusted misstatement of £120k remain unadjusted in the 2019/20 financial statements.
Group Financial Statements: Valuation of Queensway Asset	We have completed our procedures including a review of the Queensway asset by our EY Real Estates specialist. The valuation of the asset was outside of the reasonable expected range by £730k. This has not been corrected for by management.

Executive Summary

Audit risk and areas of audit focus (continued)

Our audit plan identified key areas of focus for our audit of the Authority's financial statements. We summarise below our findings for areas of audit focus:

Area of audit focus	Provisional findings & conclusions, subject to the final completion of our quality review procedures
Valuation of property, plant and equipment assets under depreciated replacement cost model	We have completed our procedures including review of the Stevenage Arts and Leisure Centre by our EY Real Estates specialist. Audit misstatements were identified and have been corrected for by management.
Preparation of Group Accounts	We have performed our audit procedures in relation to the group accounting and the scope of the group audit and have not identified any audit findings.
Queensway Lease Accounting Treatment	We have performed our audit procedures in relation to the Queensway lease accounting and identified an audit misstatement of £175k. This misstatement has not been corrected for by management. The Council should fully review its accounting model for the Queensway deal for the 2020-21 audit.
Pension liability valuation and disclosures	We have performed our audit procedures in relation to the pension liability and disclosures. As a result we have identified an audit misstatement that decreased the pension liability recognised on the Council's balance sheet by £1.5m. This has been amended for by management.
Recognition of grant income associated with Covid-19	We have performed our audit procedures in relation to the recognition of grant income associated with Covid-19. We have not identified any misstatements nor any instances of management bias in relation to this area.
Going Concern Disclosures	Subject to completion of internal consultation by EY's Professional Practice Department we have completed our procedures on going concern disclosures. We are satisfied that the Council's revised going concern disclosure is appropriate. We do not anticipate reporting of any material uncertainties in relation to going concern in our audit report.

This report sets out our observations and conclusions, including our views on areas which might be conservative, and where there is potential risk and exposure. We report our consideration of these matters, and any others identified, in the "Areas of Audit Focus" section of this report. We ask you to review these and any other matters in this report to ensure:

- There are no other considerations or matters that could have an impact on these issues; and
- You agree with the resolution of the issues; and there are no other significant issues to be considered.

There are no matters, apart from those reported by management or disclosed in this report, which we believe should be brought to your attention.

Executive Summary

Value for money

We have considered your arrangements to take informed decisions; deploy resources in a sustainable manner; and work with partners and other third parties. In our audit plan we identified a significant risk relating to financial resilience of the Council based on it's lower level of available reserves compared to other local authorities in Hertfordshire, particularly in the context of the financial challenges and uncertainties as the result of Covid-19 pandemic.

We have included in Section 4 the detailed work we are performing in response to this risk. At the time of issuing this report we have completed our planned procedures in relation to this risk, subject to final review and conclusion.

We engaged the use of specialist support from the EY Strategy and Transactions Team to conduct scenario modelling based on the Council's medium term financial strategy. The findings of which where that the Council's medium term financial strategy was reasonable and appropriate, and that the Council has sufficient reserves over the medium term. However, it is important that the Council is not complacent on its reserve balances and continues with its 'Making Your Money Count' options programme so that the Council's reserve balances are not reduced to unstainable levels.

We expect to issue an un-modified value for money conclusion.

Independence

Please refer to Section 7 for our update on Independence. There are no relationships from 1 April 2019 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

Correspondence from the Public

We did not receive any formal objections and correspondence from members of the public.

Control observations

We have adopted a fully substantive audit approach, so have not tested the operation of controls.

02 Areas of Audit Focus

Areas of Audit Focus

Fraud risk - misstatements due to fraud or error

What is the risk?

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.

What did we do?

We have completed our standard procedures to address the fraud risk, which included:

- Inquiring of management about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Considering the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.
- Performing mandatory procedures regardless of specifically identified fraud risks, including;
  - Testing of journal entries and other adjustments in the preparation of the financial statements;
  - Reviewing accounting estimates for evidence of management bias; and
  - Evaluating the business rationale for significant unusual transactions.

What are our provisional conclusions?

Our mandatory procedures did not identify any instances of management override.

Our testing of journal entry testing and have not identified any material weaknesses in controls or evidence of material management override.

We have not identified any instances of inappropriate judgements being applied.

We did not identify any other transactions during our audit which appeared unusual or outside the Authority's normal course of business.

Significant risk

Misstatements due to fraud or error – Incorrect capitalisation of revenue expenditure

What is the risk?

The Authority is under financial pressure to achieve budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way to achieve these targets.

We consider the risk applies to capitalisation of revenue expenditure. Management could manipulate revenue expenditure by incorrectly capitalising expenditure which is revenue in nature and should be charged to the comprehensive income and expenditure account.

In 2019/20 the Authority has incurred £43.1 million capital expenditure.

What judgements are we focused on?

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

We consider the risk applies to capitalisation of revenue expenditure and could result in a misstatement of cost of services reported in the comprehensive income and expenditure statement.

What did we do?

Our approach focused on:

- Sampling testing capital expenditure at a lower testing threshold to verify that revenue costs have not been inappropriately capitalised;
- Our testing examined invoices, capital expenditure authorisations, leases and other data that support capital additions. We reviewed the sample selected against the definition of capital expenditure in IAS16.
- We reviewed any 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.

What are our provisional conclusions?

We performed extensive sample testing on the Council's capital expenditure in 2019/20.

Our sample testing of property, plant and equipment additions identified 7 low value items (total cumulative value £985) for which the Council where unable to provide evidence to support the capital nature of the expenditure.

We have extrapolated these items to calculate a projected audit misstatement of £153,480. The Council has not adjusted the financial statements for this project misstatement. Refer to section 3 of this report.

We did not identify any usual journal entries that in relation to capital additions.

Significant risk

Misstatements due to fraud or error – Misclassification of capital receipts as revenue

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 judgements are we focused on?

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).

What did we do?

Our approach focused 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.

What are our provisional conclusions?

Our sample testing of the application of capital receipts from in year disposal of capital assets during 2019/20 did not identify any misstatements.

There were no net material changes during the 2019/20 year to the Council's Capital Receipts Reserve and Capital Grants Unapplied account.

However, we identified a material misstatement in relation to accounting treatment adopted for Local Enterprise Partnership (LEP) funding of capital projects in relation to the regeneration of Stevenage town centre. The Council incorrectly accounted for £4.1m of LEP funding received in year as grant income whereas it should have been accounted for as long term borrowing based on the underlying nature of the LEP agreements.

This increased the Council's Capital Financing Requirement. The Council has amended the financial statements to adjust for the LEP misstatement. Refer to section 3 of this report.

Areas of Audit Focus

Significant risk

Valuation of market based property assets
(including Property, Plant and Equipment, Council Dwellings and Investment Properties)

What is the risk?

The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty have been included in the year-end valuation reports produced by the Council's external valuers.

We consider that the material uncertainties disclosed by the valuer gave rise to an additional risk relating to disclosures on the valuation of market based properties. In addition outputs from the valuer are subject to estimation, there is a significant risk that the valuation of market based property assets may be misstated.

The Council has as significant asset base including:

- £632m of council dwelling properties,
- £163m of property, plant and equipment,
- £24m of investment properties

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

What judgements are we focused on?

We have identified a specific risk of misstatements that could affect the balance sheet.

We consider the risk applies to the valuation of market based property assets, including PPE, Council Dwellings and Investment Properties.

What did we do?

Our approach focused on:

- The adequacy of the scope of the work performed by the Council's valuers, their professional capabilities and the results of their work;
- The use of EY valuation specialists to review a sample of market based property assets valuations
- Sample testing property values to corroborate key assumptions used by the valuer in performing their valuations;
- Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated;
- Consideration of useful economic lives in the most recent valuation; and
- Testing that accounting entries had been correctly processed in the financial statements.

What are our provisional conclusions?

Our consideration of the work, professional capabilities and the results of the Council's valuers did not identify any issues.

Based on the review conducted by the EY Real Estate valuations team there were 4 properties, out of a sample of 8, where the valuation of the asset was outside of a reasonable expected range. This resulted in an audit misstatement of £1.07m understatement of the value of Property, Plant and Equipment in relation to two assets. This misstatement was amended for by management.

A further audit misstatement of £120k was identified based on the net cumulative impact of a further 5 property valuations. This misstatement was not amended for by management.

A number of assets, total value £1.2m, were identified that were last valued in 2012. This is outside the accounting framework's requirement of a valuation at least once every 5 years. Based on audit challenge management revalued a number of these assets, which resulted in a further audit adjustment of £517k which increased the valuation of PPE.

We noted that Council Dwellings valuations was understated by £609k due to the incorrect valuation figure being from the valuer's report. This has been corrected for by management.

The assumptions used in valuation of investment properties were overall reasonable. No audit misstatements were identified in relation to investment property valuations.

Our consideration of the useful economic lives in the most recent valuation did not identify any issues.

Accounting entries had been correctly disclosed in the financial statements.

Refer to section 3 of this report for information on audit misstatements.

Significant risk

Group Financial Statements: Valuation of Queensway Asset

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 value of the Queensway asset recognised in the Council's group financial statements is £11.73m.

What judgements are we focused on?

The valuation assumptions used to value the Queensway asset as of 31 March 2020.

What did we do?

Our approach focused on:

- The adequacy of the scope of the work performed by the Council's valuers, their professional capabilities and the results of their work;
- The use of EY valuation specialists to review the valuation of the Queensway asset.
- 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 that accounting entries had been correctly processed in the financial statements.

What are our provisional conclusions?

Our consideration of the work, professional capabilities and the results of the Council's valuers did not identify any issues.

Based on the review conducted by the EY Real Estate valuations team we considered that a reasonable valuation range for the Queensway asset as of 31 March 2020 was between £10 to £11m. The value of asset was £730k above the maximum reasonable range for the valuation of the asset. In particular the market rent assumptions used by the Council's valuer were above those that could reasonably be expected.

We have treated the £730k difference as an audit misstatement. This has not been adjusted for by management. (This unadjusted audit difference is included within the £120k net remaining difference on property valuations, as referred to section 3 of this report).

Accounting entries had been correctly disclosed in the financial statements.

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 did we do?
Valuation of property, plant and equipment assets under depreciated replacement cost model – inherent risk 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 £23.3m as of 31 March 2020, and the outputs from the valuer are subject to estimation, there is a higher inherent risk that the valuation of theses assets may be under/overstated or the associated accounting entries incorrectly posted.	We have: • Considered 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; • Engaged EY Real Estate valuations team to review the Council highest value asset £14.4m (Arts and Leisure Centre) • Sample tested key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre); • Tested accounting entries, ensuring these have been correctly processed in the financial statements. Our conclusions are: Our consideration of the work, professional capabilities and the results of the Council's valuers did not identify any issues. Based on the review conducted by EY Real Estate valuations team on the valuation of the Arts and Leisure Centre £14.4m was within a reasonable valuation range. An audit misstatement of which undervalued the valuation of Stevenage Swimming Pool by £822k was identified. This misstatement has not been adjusted for by management (This unadjusted audit difference is included within the £120k net remaining difference on property valuations, as referred to section 3 of this report). Appropriate accounting entries have been adopted within the financial statements for valuations of Property, Plant and Equipment. were found to be correctly .

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 did we do?
Preparation of Group Accounts – inherent risk 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 have: • Enquired with management to understand the processes and controls in place for how intra-group transactions and balances are identified. • Substantively tested 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. • Reviewed 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. Our conclusions are: The processes and controls in place for the identification of intra-group transactions and balances are appropriate. Substantive testing on the group consolidation of Queensway LLP accounts into the Council's group financial statements did not identify any misstatements. Consolidation adjustment made by the Council are compliant with the CIPFA Code and IFRS 10.

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 did we do?
Queensway Lease Accounting Treatment – inherent risk 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 have: • Reviewed 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. • Considered whether the appropriate accounting journal entries are consistent with the prevailing accounting standard IAS 17 Leases. • Reviewed the relevant lease disclosures in the Council's financial statements. We engaged EY financial reporting specialists to assist the audit team in reviewing the accounting treatment adopted. Our conclusions are: Based on feedback from the 2018/19 audit the Council has amend its Queensway lease and borrowing model to revise the interest rate adopted on the borrowing element of the Queensway deal. However, the interest rate calculated by the Council is not correct due to the incorrect split of lease repayment amounts between repayment of principal and repayment of interest in the model. The impact of this difference for the 2019/20 group financial statements of the Council is that the long term lease liability, on the balance sheet, is overstated by £175k and also the interest cost, recognised in the comprehensive income and expenditure statement, is overstated by £175k. We have treated this as an audit misstatement that has not been corrected for by management. Refer to section 3 of this report for further information. We recommend that the Council's reviews in totality the Queensway lease and borrowing model for 2020/21. This may require the Council to draw upon external specialist accounting advice. Each year this matter remains unresolved the audit misstatement will increase, eventually it will be material to the audit.

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 did we do?
Pension liability valuation and disclosures – inherent risk 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 2020 this totalled £39 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 have: • Liaised with the auditors of Hertfordshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Stevenage Borough Council; • Assessed 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 • Reviewed and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. • Assessed the results of the triennial valuations, including the assumptions used and the impact on the Council's pension liability. • Engaged early with the Council, and their actuary, to understand any ongoing impact of the McCloud judgement and GMP rulings on the IAS19 liability. • Considered 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. Our conclusions are: We received the Pension Fund Assurance letter from the auditors of Hertfordshire Pension Fund. This highlighted that the investment returns for the year end 31 March 2020 as estimated by the actuary (-3%) was different compared to that as reported by the Pension Fund (-1.3%). A revised IAS 19 results report was obtained by the Council from the actuary to update for this. In addition, the audit of the pension investments held by the Pension Fund identified valuation misstatements of which the Council has a share of these. In total, the value of the Council's pension liability on it's balance sheet decreased from £40.9m to £39.4m as the result of audit adjustments to the financial statements. Refer to section 3 of this report for further information. The accounting entries and pension liability related disclosures in the financial statements were appropriate.

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 did 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 have: • Considered the revenue and capital grants received by the Council; • Assessed 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. <u>Our conclusions are:</u> The Council did not receive a material amount of Covid-19 support funding for itself in the 2019/20 year. The Council did however receive Covid-19 business support funding to provide financial support to the local businesses of Stevenage in March 2020. Based on our substantive testing on cut-off around the financial year end of 31 March 2020 we did not identify any instances of inappropriate recognition this money in the Council's financial statements. Based on the grant testing performed during the audit we did not identify any management bias in relation to recognition of grant income related to Covid-19

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 did we do?
Going concern disclosures The auditor's report in respect of going concern covers a 12-month period from the date of the audit report. Therefore the Council's assessment and financial statement going concern disclosures need to cover this future prospective period. 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'. Covid-19 has created a number of financial pressures throughout Local Government. For Stevenage Borough Council the estimated cumulative loss as the result of Covid-19 through to March 2023 is approximately £10m. 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. Financial support from Central Government does not cover all of the Council's losses.	Findings and conclusion: Officers have carried out an assessment of the impact of Covid-19 on the Council's income, expenditure, balances and reserves to inform reporting to the Audit Committee and other members. These assessments have been used to enhance the disclosure in the financial statements around the going concern assertion. We have reviewed the assessment, focusing on the reasonableness of the financial impact assessment, cashflow and liquidity forecasts, known outcomes, sensitivities, mitigating actions and key assumptions, including around reductions in fees and charges. We have also considered the adequacy of the revised disclosure note and its consistency with the going concern assessment and our audit procedures. The Council is currently forecasting £1.2 million of additional cost pressures as a result of Covid-19 during the 2022/23 year. This is partly mitigated by grant funding from Central Government. The Council's forecast level of general fund balance as at 31 March 2023 is £3.7m which is above the Council's risk assessed minimum balance of the general fund by £0.4m. The Council's cash flow modelling through to March 2023 demonstrates that it is able to work within its capital financing requirement. The Council is forecasting a liquidity position of cash and short term investment balances of £47m as of 31 March 2023. We have reviewed the revised going concern disclosure and are satisfied that it adequately reflects the Council's assessment and informs the reader of the impact of the Covid-19 pandemic on the Council's finances. We are currently now completing our internal consultation with our Professional Practice Directorate on our audit work and assessment of the Council's financial statement going concern disclosure. We do not anticipate reporting a material uncertainty in our audit report in relation to going concern.

03 Audit Differences

Audit Differences

In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and the disclosures and amounts actually recorded. These differences are classified as “known” or “judgemental”. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

Summary of unadjusted audit differences

The following audit differences, above our reporting threshold of £52,777, have not been amended for by management in the 2019/20 statement of accounts:

- Inappropriate capitalisation of revenue expenditure – Based on representative capital additions testing we have determined an extrapolated misstatement of £153k, which overstates the balance of property, plant and Equipment and understates the Council’s revenue expenditure. This unadjusted misstatement would impact the Council’s general fund.

- Valuation of property, plant and equipment – Differences were identified on the valuation of individual properties, these ranged from £822k overvalued to £733k undervalued. This differences are as the result of the underlying methodology and assumptions used by the Council’s valuer. The total net cumulative impact of unadjusted differences in relation to property valuations that we are reporting is £120k. This misstatement overstates the balance of Council’s property, plant and equipment and of the Council’s revaluation reserve (an unusable reserve) by £120k.

- Queensway lease accounting treatment – Based on our review procedures of the Queensway lease and borrowing models we have identified an audit difference of £175k which overstates both the long term lease liability on the Council’s balance sheet and also the interest cost recognised as expenditure.

Audit Differences

Summary of adjusted audit differences

In total there were 9 audit adjustments that have been amended for by management in the 2019/20 statement of accounts. We report to the Audit Committee significant audit differences (above our performance materiality threshold of £0.792m) that have been amended for in the financial statements. The significant audit differences that have been adjusted for include:

- Accounting treatment of Local Enterprise Partnership (LEP) funding for capital regeneration scheme in Stevenage. The Council has applied the incorrect accounting treatment to LEP funding. The Council has multiple LEP funding agreements, some of which are non-repayable and some of which are repayable. The repayable funding should be accounted for as borrowing. In addition, the Council had not considered the soft-loan element of the borrowing. Furthermore, the Council accrued £1.3m of LEP funding as a debtor at year end, however the nature of this funding was actually borrowing and it is not standard accounting practice to accrued for borrowing before it is received.
- The total audit adjustment in relation to LEP funding was:
  - Grant income received in year decreased by £4.1m
  - Long term liabilities increased by £3.2m
  - Receivables (debtors) decreased by £1.3m
  - Capital adjustment account (unusable reserve) increase by £0.4m (Soft-loan element)

- Pension liability – The valuation of the pension liability decreased by £1.56m as the result of the revised IAS19 report from the actuary and the findings from the audit of Hertfordshire Pension Fund, in relation to the valuation of investment assets held by the Pension Fund. This adjustment decreased both the pension liability and the pension reserve (unusable reserve) by £1.56m. This had no impact on the Council's usable reserves for 2019/20.

- Property, Plant and Equipment valuations – Adjusted differences in relation to the valuation of properties asset were identified that increased both the value of the Property, Plant and Equipment and the revaluation reserve (unusable reserve) by £1.07m. This had no impact on the Council's usable reserves for 2019/20.

Other audit differences that were above our reporting threshold, £0.053m, but below our performance materiality threshold of £0.792m which have been amended for in the 2019/20 statement of accounts include:

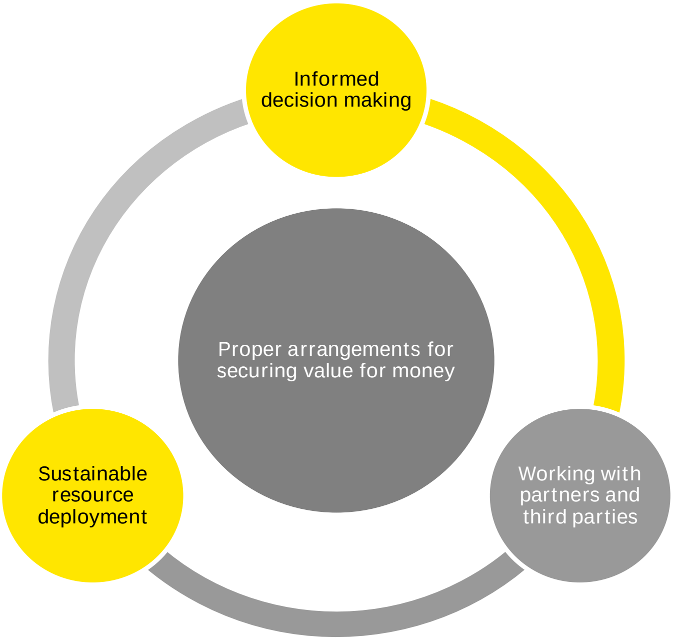
- Valuation of council dwelling properties.
- PPE additions that had not been accrued for, and also PPE additions that had been inappropriately accrued for.
- Over and under measurement of revenue expenditure accruals.
- Omitted journal entry postings in relation to NNDR income for the Council.

In addition there were disclosure misstatements in the draft 2019/20 statement of accounts that have been corrected for. The significant disclosure differences that have been amended for were:

- Clerical casting errors and internal inconsistencies between disclosures in the financial statements.
- Disclosures in the draft statement of accounts document itself had not been updated since the prior year accounts.
- The classification of cash flows in the Statement of Cash Flows in relation to the LEP funding adjustment.

04 Value for Money Risks

Value for Money



Background

We are required to consider whether the Authority 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.

Impact of covid-19 on our Value for Money assessment

On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19.

This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider Local Authorities' response to Covid-19 only as far as it relates to the 2019/20 financial year; only where clear evidence comes to the auditor's attention of a significant failure in arrangements as a result of Covid-19 during the financial year, would it be appropriate to recognise a significant risk in relation to the 2019/20 VFM arrangements conclusion.

Overall conclusion

We identified one significant risk around these arrangements. The table below presents our findings in response to the risk identified in our Audit Plan as well as any risks identified since then and any other significant weaknesses or issues we want to bring to your attention.

Our audit procedures on your arrangements to secure economy, efficiency and effectiveness in your use of resources as substantially complete and are subject to review.

Value for Money Risk

We are only required to determine whether there are any risks that we consider significant within the Code of Audit Practice, where risk is defined 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 enough work to deliver a safe conclusion on your arrangements to secure value for money, and enables us to determine the nature and extent of any further work needed. If we do not identify a significant risk we do not need to carry out further work.

The table below presents the findings of our work in response to the risks areas in our Audit Planning Report as well as any additional risks identified since then.

What is the significant value for money risk?	What arrangements did the risk affect?	What did 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 had estimated this increased financial pressure to be £6.1 million for the initial 6 month period; however given the unprecedented circumstances there was 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.	• Deploying resources in a sustainable manner.	To address this risk, we engaged specialist support from EY's Strategy and Transactions team to work with the audit team in reviewing, challenging and exercising appropriate professional scepticism on the Council's medium-term financial strategy, including: • Identification of the key assumptions contained in the medium-term financial plan and the reasonableness of the basis of these; • Reviewed the Council's stress testing of these assumptions; sensitivity analysis and mitigating actions. • Developed an understanding of how the Council identifies its budget gaps and risk mitigations; • Stress tested the Council's financial resilience and adequacy of available reserves and balances before and in light of Covid-19. • Assessed the Council's track record on delivering savings and the robustness of its future savings plans. • Reviewed the process by which the Council risk assesses its minimum required level of reserves. Subject to final review, our findings and conclusions in relation to this value for money risk are on the next page:

Value for Money Risk (continued)

What are our findings and conclusion?

Findings:

Our modelling suggests that the Council's forecasts within the current financial year and over the medium-term financial strategy are both reasonable and appropriate compared with our base-case economic scenario, including the likely impacts of Covid-19 on the Council's finances. It is however noted that our modelling of the the financial challenges that the Council faces over the medium is forecast to be considerably more severe in our more volatile economic conditions.

Our modelling suggests that over the medium term the Council has sufficient reserve balances to meet the financial challenges of the base-case economic scenario. However, it is important that the Council is not complacent on its reserve balances and continues with its 'Making Your Money Count' options programme so that the Council's reserve balances are not reduced to unstainable levels.

Fig. 4 - Medium Term Financial Challenge 2020/21 - 2023/24

Source: EY Financial Resilience Model

The Council's planned use of resources over the medium term is set out in their medium term financial strategy. The Council risk assessment of its required minimum level of reserves is appropriate based on the Council's risk appetite and future planed use of resources for the people of Stevenage.

Overall Conclusion:

We currently expect to report an un-modified value for money conclusion in relation to the 2019/20 audit.

05 Other reporting issues

Other reporting issues

Consistency of other information published with the financial statements, including the Annual Governance Statement

We must give an opinion on the consistency of the financial and non-financial information in the Statement of Accounts 2019/20 with the audited financial statements.

We must also review the Annual Governance Statement for completeness of disclosures, consistency with other information from our work, and whether it complies with relevant guidance.

Financial information in the Statement of Accounts 2019/20 and published with the financial statements was consistent with the audited financial statements.

We have reviewed the Annual Governance Statement and can confirm it is consistent with other information from our audit of the financial statements and we have no other matters to report.

Whole of Government Accounts

Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review, and the nature of our report, is specified by the National Audit Office.

Procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission for 2019/20 are no longer required based on the current timetable of the 2019/20 Whole of Government Accounts.

Other reporting issues

Other powers and duties

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Council to consider it or to bring it to the attention of the public (i.e. “a report in the public interest”). We did not identify any issues which required us to issue a report in the public interest.

We also have a duty to make written recommendations to the Council, copied to the Secretary of State, and take action in accordance with our responsibilities under the Local Audit and Accountability Act 2014. We did not identify any issues.

Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must tell you significant findings from the audit and other matters if they are significant to your oversight of the Authority’s financial reporting process. They include the following:

- Significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures;
- Any significant difficulties encountered during the audit;
- Any significant matters arising from the audit that were discussed with management;
- Written representations we have requested;
- Expected modifications to the audit report;
- Any other matters significant to overseeing the financial reporting process;
- Findings and issues around the opening balance on initial audits (if applicable);
- Related parties;
- External confirmations;
- Going concern; and
- Consideration of laws and regulations.

We have made the several observations and recommendations as the result of the 2019/20 audit, please refer to the next page.

Other than the observations and recommendations (as stated on the next page) we have no other matters to report.

Other reporting issues

Other matters

<u>Observations and recommendations resulting from the 2019/20 audit</u>

As the result of the 2019/20 audit, we have made the following observations on the capacity and resilience of the Council's finance team, as well as the processes in place for the Council to be prepared for an audit:

- The capacity and resilience of the Council's finance team should be reviewed to consider if there is sufficient capacity for the Council to proactively consider the financial reporting implications. Whether that is a change in accounting standard or whether there is a new source of funding or major project undertaken by the Council. For example if the accounting treatment of the LEP funding had been proactively considered by the Council in advance of the audit, then the time taken to complete audit would reduced. There is a risk of similar occurrences in future years without sufficient capacity in the Council's finance team.

- The quality of the Council's working papers to support the audit of it's financial statements should be improved. The Council's working papers for the audit were often difficult and time consuming to understand. This increases the risk of the audit overrunning and resulting in higher audit fees for the Council.

- The Council's financial reporting processes for its capital assets (Property, Plant and Equipment and Investment Properties) should be reviewed to identify potential efficiencies. The Council's current process for reporting the value of it's capital asset is very manual and requires multiple adjustments to be made from the fixed asset register system (RAM). This is time consuming for both the Council's officers to prepare and for the audit team to review. There may be improved technological and automated processes available. There is a risk that the reporting and audit of the Council's capital assets is more complicated, time consuming and costly than necessary.

- The Council should review the Queensway lease and borrowing accounting models. This may require the Council to draw upon external specialist accounting advice. The methodology and calculations used in the model are likely to result in a material misstatement in the Council's financial statements at a future point in time.

We note that the Council has already taken positive steps to address the observations and recommendations noted above in advance of the 2020/21 audit, including recruitment of permanent posts for Technical Finance Manager and Associate Director for Finance. In addition the Council is reviewing it's working papers to support the 2020/21 financial statements in advance of the 2020/21 audit.

06 Assessment of Control Environment

Assessment of Control Environment

Financial controls

It is the responsibility of the Authority to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Authority has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your 2019/20 financial statements of which you are not aware.

Commentary for 2020/21 financial statements and audit:

During the 2021 calendar year there was considerable turnover of key finance officers at Stevenage Borough Council. While this does not directly impact the control environment in place during the 2019/20 financial year, it does raise questions on the effectiveness of the internal control environment at the Council to prevent and detect material misstatements for the 2020/21 financial statements of the Council. We will consider the impact of this as part of the 2020/21 financial statement audit risk assessment and procedures.

We note that the Council has taken the decision to retain an agency member of staff through the end of the 2019/20 audit and into the 2020/21 audit in order to retain knowledge across financial years and to review working papers that support the 2020/21 financial statements in advance of the 2020/21 audit.

07 Independence

Confirmation

We confirm that there are no changes in our assessment of independence since our confirmation in our Audit Plan dated 9 June 2020.

We complied with the APB Ethical Standards. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your Audit Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the Audit Committee on 28 February 2022.

Relationships, services and related threats and safeguards

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY) and your Authority, and its directors and senior management and its affiliates, including all services provided by us and our network to your Authority, its directors and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 01 April 2019 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

Services provided by Ernst & Young

Below includes a summary of the fees that you have paid to us in the year ended 31 March 2020 in line with the disclosures set out in FRC Ethical Standard and in statute.

We confirm that none of the services listed in have been provided on a contingent fee basis.

As at the date of this report, there are no future services which have been contracted and no written proposal to provide non-audit services has been submitted.

Fee analysis

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2020.

We confirm that we have not undertaken non-audit work outside the NAO Code requirements. We have adopted the necessary safeguards in completing this work and complied with Auditor Guidance Note 1 issued by the NAO.

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.

	Final fee 2019/20	Scale fee 2019/20	Final Fee 2018/19
	£	£	£
Scale fee – Code work	49,283	49,283	49,283
Scale fee variation – Code work	TBC (Note 1)	-	28,142
Total Audit Fee	TBC (Note 1)	49,283	77,425
Other non-audit services (Housing Benefits Certification)	38,800	-	24,400
Total All Fees	TBC (Note 1)	49,283	101,825

All fees exclude VAT

Note 1

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). As communicated in our audit plan dated June 2020 we estimated the audit indicative fee for Stevenage Borough Council would be between £120k and £150k based on on the risk profile of the Council.

At the conclusion stage of the audit, we estimate the total 2019/20 audit fee for Stevenage Borough Council to be between £175k and £185k. The CFO does not currently agree with this audit fee. However, we consider that the fee is reflective of both (i) the areas of scope for the audit that are not included in PSAA's base scale fee, including:

- Audit of the Council's group financial statements
- Complexities of the Queensway lease arrangement.
- the Council's value for money risk, associated with financial resilience.
- the increase in expectations of the quality of the audit driven by increased FRC requirements.

and (ii) the complexities encountered during the 2019/20 audit of the Council, including:

- the impacts of Covid-19 on the audit, including our re-assessment of audit risks and response to those risks, including reduced materiality for the audit.
- the number and complexity of audit differences identified during the audit,
- the extent of specialist support required from internal EY teams to respond appropriately to the risks of material misstatement.
- the successive turnover of the key finance contacts (5 individuals), with little handover between officers.
- the quality of the Council's working papers to support the financial statements and the audit.

Independence

Fee analysis (continued)

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 Stevenage Borough Council and the audit complexities encountered the extent of audit procedures now required mean it will take approximately 1,600 hours to complete a quality audit, due the complexities of the 2019/20 audit for Stevenage Borough Council, the 2019/20 audit has take over 3,200 hours. Your scale fee is £49,283 and our current estimate is a final fee is between £175,000 and £185,000.

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, use of our internal specialists and increased correspondence with external 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.

Fee analysis (continued)

Summary of key factors (continued)

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

We have informed the CFO of the proposed audit fee for the 2019/20 audit. The CFO does not agree with the total audit fee of £175k to £185k.

We will share and discuss the detail of the scale fee variation with the CFO for further comment. We will submit our proposed scale fee variation to PSAA for their review and determination.

We will communicate with this Audit Committee at the next available opportunity the outcome of this process.

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 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 2021
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 2021: https://www.ey.com/en_uk/about-us/transparency-report-2021

08 Appendices

Appendix A

Required communications with the Audit Committee

There are certain communications that we must provide to the Audit Committees of UK clients. We have detailed these here together with a reference of when and where they were covered:

		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.	Audit Plan – June 2020
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Plan – 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 – February 2022

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		Our Reporting to you
Required communications	What is reported?	When and where
Major Local Authorities	For the audits of financial statements of public interest entities our written communications to the Audit Committee include: • A declaration of independence • The identity of each key audit partner • The use of non-member firms or external specialists and confirmation of their independence • The nature and frequency of communications • A description of the scope and timing of the audit • Which categories of the balance sheet have been tested substantively or controls based and explanations for significant changes to the prior year, including first year audits • Materiality • Any going concern issues identified • Any significant deficiencies in internal control identified and whether they have been resolved by management • Subject to compliance with regulations, any actual or suspected non-compliance with laws and regulations identified relevant to the audit committee • Subject to compliance with regulations, any suspicions that irregularities, including fraud with regard to the financial statements, may occur or have occurred, and the implications thereof • The valuation methods used and any changes to these including first year audits • The scope of consolidation and exclusion criteria if any and whether in accordance with the reporting framework • The completeness of documentation and explanations received • Any significant difficulties encountered in the course of the audit • Any significant matters discussed with management • Any other matters considered significant	Audit Plan – June 2020 and Audit Results Report – February 2022

Appendix A

Required communications	What is reported?	Our Reporting to you: 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 – February 2022
Misstatements	• Uncorrected misstatements and their effect on our audit opinion • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Material misstatements corrected by management	Audit Results Report – February 2022
Subsequent events	• Enquiry of the Audit Committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements.	Audit Results Report – February 2022
Fraud	• Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the Authority • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • Unless all of those charged with governance are involved in managing the Authority, any identified or suspected fraud involving: a. Management; b. Employees who have significant roles in internal control; or c. Others where the fraud results in a material misstatement in the financial statements. • The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected • Any other matters related to fraud, relevant to Audit Committee responsibility.	Audit Results Report – February 2022

Appendix A

Required communications	What is reported?	Our Reporting to you When and where
Related parties	Significant matters arising during the audit in connection with the Authority'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 Authority	Audit Results Report – February 2022
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 Communications whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place. For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2016: • Relationships between EY, the company and senior management, its affiliates and its connected parties • Services provided by EY that may reasonably bear on the auditors' objectivity and independence • Related safeguards • Fees charged by EY analysed into appropriate categories such as statutory audit fees, tax advisory fees, other non-audit service fees • A statement of compliance with the Ethical Standard, including any non-EY firms or external experts used in the audit	Audit Plan – June 2020 and Audit Results Report – February 2022

Appendix A

Required communications	What is reported?	Our Reporting to you: When and where
	• Details of any inconsistencies between the Ethical Standard and Authority's policy for the provision of non-audit services, and any apparent breach of that policy • Details of any contingent fee arrangements for non-audit services • Where EY has determined it is appropriate to apply more restrictive rules than permitted under the Ethical Standard • The audit committee should also be provided an opportunity to discuss matters affecting auditor independence	
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures.	We have received all requested confirmations
Consideration of laws and regulations	• Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur • 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 committee may be aware of	We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations
Significant deficiencies in internal controls identified during the audit	• Significant deficiencies in internal controls identified during the audit.	Audit Results Report – February 2022

Appendix A

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
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 Results Report – February 2022
Written representations	• Written representations we are requesting from management and/or those charged with governance	Audit Results Report – February 2022
Material inconsistencies or misstatements	• Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report – February 2022
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report – February 2022
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 Plan – June 2020 and Audit Results Report – February 2022

Management representation letter

Management Rep Letter

To follow as a separate item in the Audit Committee papers.

Draft audit report

This is an example report. Our audit report will not be completed and issued until the work and internal consultation are complete.

Our opinion on the financial statements

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF Stevenage Borough COUNCIL

Opinion

We have audited the financial statements of Stevenage Borough Council for the year ended 31 March 2020 under the Local Audit and Accountability Act 2014. The financial statements comprise the:

- Authority and Group Movement in Reserves Statement,
- Authority and Group Comprehensive Income and Expenditure Statement,
- Authority and Group Balance Sheet,
- Authority and Group Cash Flow Statement and the related notes 1 to [x];
- Collection Fund and the related notes 1 to [x]]; and
- Statement of Accounting Policies

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20.

In our opinion the financial statements:

- give a true and fair view of the financial position of Stevenage Borough Council as at 31 March 2020 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of Stevenage Borough Council in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard and the Comptroller and Auditor General's AGN01, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The other information comprises the information included in the Statement of Accounts 2019/20, other than the financial statements and our auditor's report thereon. The Chief Finance Officer is responsible for the other information.

Appendix C - Audit Report

Our opinion on the financial statements

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinion on other matters prescribed by the Local Audit and Accountability Act 2014

Arrangements to secure economy, efficiency and effectiveness in the use of resources

In our opinion, based on the work undertaken in the course of the audit, having regard to the guidance issued by the Comptroller and Auditor General in April 2020, we are satisfied that, in all significant respects, Stevenage Borough Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020.

Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Council;
- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects.

Responsibility of the Chief Finance Officer

As explained more fully in the Statement of Responsibilities set out on pages [...], the Chief Finance Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20, and for being satisfied that they give a true and fair view.

In preparing the financial statements, the Chief Finance Officer is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Authority either intends to cease operations, or have no realistic alternative but to do so.

Appendix C - Audit Report

Our opinion on the financial statements

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in April 2020, as to whether Stevenage Borough Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether Stevenage Borough Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, Stevenage Borough Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office (NAO) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack. We are satisfied that this work does not have a material effect on the financial statements or on our value for money conclusion.

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