Chichester District Council

Audit planning report update

Year ended 31 March 2020

June 2020

Building a better working world

Members of the Corporate Governance and Audit Committee

12 June 2020

Chichester District Council
East Pallant House
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Dear Corporate Governance and Audit Committee Members

Audit Planning Report update – Year ended 31 March 2020

This report seeks to provide the Corporate Governance and Audit Committee with an update to our risk identification for the 2019/20 audit, reflecting the changes in risks identified in the current year.

In our audit planning report submitted for the 26 March Corporate Governance and Audit Committee, we provided you with an overview of our audit scope and approach for the audit of the financial statements. Following the coronavirus outbreak (Covid-19) in March 2020, this meeting was cancelled and we have since re-assessed our audit scope and strategy. We provide an update to the significant accounting and auditing matters, and audit approach outlined in the Audit Planning Report.

Section 1 - changes to audit risks
Section 2 – changes to audit scope

If you have any queries in respect of this report, please contact me.
Yours faithfully

Kevin Suter

For and on behalf of Ernst & Young LLP

01 Audit risks

Our response to significant risks

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

Risk of fraud in revenue recognition*

Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. We focus our testing on capital additions (£3.8m in 2019/20) and Revenue expenditure funded from capital under statute (REFCUS) (£3m in 2019/20).

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We have identified an opportunity and incentive to capitalise expenditure under the accounting framework, to remove it from the general fund. This would result in funding expenditure that should properly be defined as revenue, through inappropriate sources such as capital receipts, capital grants, or borrowing. We believe the significant risk manifests itself within PPE additions and REFCUS.

Update – Covid-19 expenditure

No change to the risk from Covid-19 in 2019/20 and no change to planned procedures.

Our response to significant risks (continued)

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

Valuation of Land and Buildings and Investment Properties

Financial statement impact

The net book value of land and buildings in the 19/20 accounts is £117m whilst the fair value of investment properties is £13.623m

What is the risk?

The fair value of 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. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

There have been a number of errors identified in this area over the last three years.

Update – Covid-19 related constraints on property valuation

The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, has 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. Asset valuations were performed by the Council's valuer between December 2019 and February 2020, before the impact of Covid-19. Management are currently reviewing these valuations to determine whether there has been any material fluctuations in valuation between the valuation date and the balance sheet date.

This impact is expected to affect PPE valued at Existing Use Value as the valuation basis for these properties are linked to recent market transactions. Given the significant change in market conditions since the onset of Covid-19 in early 2020, it is important that a valuation is carried out at the measurement date. It is likely to be inappropriate to rely on a valuation at an earlier date. We have therefore increased the level of risk from 'other financial statement risk' to a significant risk.

Furthermore, since late March 2020 in the UK, Covid-19 has had a dramatic impact on the occupation of buildings due to the forced closure of restaurants, retail stores, leisure, offices and hotels due to government regulation. We do not know how long the government's measures will last or how long businesses will be impacted. Rental income is expected to fall as tenants may default on their rents and seek to negotiate rent reductions as the tenants can no longer trade effectively. This could have a significant impact on investment properties and we have therefore raised a significant risk in relation to investment property valuations.

Our response to significant risks (continued)

We will:

- Consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer;
- Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE.
- Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated; and
- Test accounting entries have been correctly processed in the financial statements.

Additional Covid-19 procedures in response to our risk include:

- Consider the Council's asset base by type of asset and valuation methodology, as impacts are likely to be more significant for assets valued on the basis of data from market transactions;
- Ensure the appropriate disclosure has been made in the accounts concerning the material uncertainty, including in Note 5 'Assumptions made about the future and other major sources of estimation uncertainty'; and
- Obtain input from EY Real Estates, our internal specialists on asset valuations for PPE and Investment Properties, including inputs on market sentiment and how it has been reflected in the ERVs/yields.

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 and therefore may be key audit matters we will include in our audit report.

What is the area of focus?	What will we do?
Going concern The Council prepares its accounts on the assumption that it will continue as a going concern. Ordinarily the Council supports this assertion with its Medium Term Financial Strategy (MTFS) and budget for the next financial year. However, the current and future uncertainty over the impact of Covid-19, the impact on material income streams and the uncertainty over the level of government funding increases the need for the Council to revisit its financial planning and undertake a detailed assessment to support its going concern assertion. The Council is heavily reliant on income from fees and charges (in excess of £18m) to support its cash position and these income streams are under significant threat due to Covid-19. From an audit perspective, the auditor's report going concern concept is a 12-month outlook from the audit opinion date, rather than the balance sheet date. So, for the 2019/20 accounts, for example, we will need to see evidence of an assessment up to and including around July 2021. We will also discuss with management the potential for further disclosures in the 2019/20 accounts on going concern and in particular any material uncertainties.	Our approach will focus on: • Reviewing management's assessment of going concern as part of our work under ISA (UK) 570 (Revised June 2016) Going Concern, and whether any required disclosures are included within the Statement of Accounts; • Consider the Council's future cash flow projections and stress testing to determine whether they support the use of the going concern assumption, including any assumptions on external borrowing and repayments; • Obtaining evidence that management's assumptions are appropriate and any material uncertainties have been disclosed; • Review the Council's approach to identifying and disclosing events after the balance sheet date; and • Consider the impact on our audit report and comply with EY consultation requirements.
New accounting standard – IFRS 16 In our Audit Planning Report drafted in March we identified an inherent risk in relation to the implementation of the new accounting standard on leases. Due to the impact Covid-19, the adoption of IFRS 16 (Leases) was deferred to 21/22.	Since IFRS 16 (Leases) has not yet been adopted by the Code, the Council no longer needs to disclose the financial impact of this new accounting standard in the 19/20 accounts. We therefore no longer consider this to be an areas of audit focus.

Additional Procedures

Audit Process overview

Additional audit procedures as a result of Covid-19

Other changes in the entity and regulatory environment as a result of Covid-19 that have not resulted in an additional risk, but result in the following impacts on our audit strategy are as follows:

- Information Produced by the Entity (IPE): There is an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the likely inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We will:
    - Use the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we're auditing; and
    - Agree IPE to scanned documents or other system screenshots.
- Additional EY consultation requirements concerning the impact on auditor reports.

The changes to audit risks and audit approach will change the level of work we perform. This may impact the audit fee. We will agree changes to the audit fee with management and report back to the Corporate Governance and Audit Committee in our Audit Results Report.

Materiality

Materiality
We have considered the materiality levels we reported to you in our Audit Planning Report, and whether any change to our materiality is required in light of Covid-19. Following this consideration we remain satisfied that the values for planning materiality, performance materiality and our audit threshold for reporting differences reported to you in our Audit Planning Report remain appropriate.