

Audit Committee - 26 September 2019
Agenda Item 8 - External Auditors
Annual Audit Letter

Three Rivers District Council

Annual Audit Letter for the year
ended 31 March 2019

August 2019

Contents



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.psa.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 set 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 Annual Audit Letter is prepared in the context of the Statement of responsibilities and Terms of Appointment. 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 Steve Varley, 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

We are required to issue an annual audit letter to Three Rivers District Council (the Council) following completion of our audit procedures for the year ended 31 March 2019. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's:	
▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2019 and of its expenditure and income for the year then ended.
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 22 July 2019
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 13 August 2019.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.



Maria Grindley

Associate Partner

For and on behalf of Ernst & Young LLP



02

Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2018/19 Audit Results Report to the 23rd July 2019 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2018/19 audit work has been undertaken in accordance with the Audit Plan that we issued on 11th March 2019 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2018/19 financial statements; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £500mn. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



03

Financial Statement Audit



Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council [and Pension Fund]'s Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2019.

Our detailed findings were reported to the 23 July Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
<p>Misstatements due to fraud or error</p> <p>As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.</p> <p>We identify and respond to this risk on every audit engagement.</p>	<p>We:</p> <ul style="list-style-type: none"> • Inquired of management about risks of fraud and the controls put in place to address those risks; • Understood the oversight given by those charged with governance of management's processes over fraud; • Considered of the effectiveness of management's controls designed to address the risk of fraud; • Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; • Assessed accounting estimates for evidence of management bias; and • Evaluated the business rationale for significant unusual transactions. <p>Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Authority's financial position.</p>
<p>Incorrect accounting for manual accruals</p> <p>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.</p> <p>In considering how the risk of management override may present itself, we conclude that this is primarily through management taking action to override controls and manipulate in year financial transactions that impact the financial position.</p> <p>A key way of improving the revenue position is through inappropriate timing or measurement of estimates, manual accruals around the year end being a typical estimate that could be affected.</p>	<p>We:</p> <p>Focused our journals testing strategy around the year-end period, with a particular focus on those manual entries that impact income and expenditure.</p> <p>Where there was any management estimation or assumptions involved in the calculation of year end accruals we ensured that the rationale provided by management is appropriate and clearly documented on file via minutes of conversations held by management.</p> <p>Our audit work did not identify any issues.</p>

Financial Statement Audit (cont'd)

Other Key Risk Areas	Conclusion
Valuation of Other Land and Buildings	Land and Buildings within Property, Plant and Equipment were valued at £52,519,000 at 31 March 2018 and Investment Properties were valued at £3,369,000 as at that date. These represent significant balances in Three River's District Council's accounts and were subject to valuation changes over the course of 2019/20. We tested valuation movements, including data, assumptions, methodology and policies and accounting entries. There were no issues identified from our work.
Other Additions to the Capital Programme	2017-18 saw Additions to Property, Plant and Equipment of £13,464,000. Even with routine capital acquisitions and enhancements, there is an inherent risk that revenue expenditure could be incorrectly capitalised. We sample tested additions. There were no issues identified from our work.
Valuation of Pension Fund Assets and Liabilities	One audit difference was identified for adjustment from our work. The IAS19 report received from Hymans Robertson on 12th April was revised on 28th June. Net Pension Liabilities were restated from £25,929,000 to £26,672,000, with an overall net increase in Total Comprehensive Expenditure of £743,000. This related to the national McCloud ruling issue and was reflected in a revised version of the accounts.
Accounting for South Oxhey Park	Significant adjustments were made to the accounting treatment in 2017/18. The net impact had been to increase inventories by £4,900,000 and the deferral of £18,100,000 of other income in income statement to the deferred revenue receipt account. We confirmed there has been no change in the intended future of the asset and the accounting treatment remains consistent with our understanding. At 31 March 2019, South Oxhey Park inventory and deferred income were valued at £16,277,000.
Valuation of NNDR Appeals Provision	This is a high value estimate driven by complex calculations. We considered the work performed by Inform, including the scope of the work, data provided to Inform and assumptions used. We also compared the level of appeals at 31 March 2019 and 31 March 2018 to assess the reasonableness of amounts provided for at year end. There were no issues identified from our work.
New Accounting Standards	We assessed implementation arrangements for IFRS9 (Financial Instruments) and IFRS15 (Revenue from contracts with customers). There were no issues identified from our work.

Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £1,060,000 (2017/18: £1,060,000), which is 2% of Gross Revenue Expenditure reported in the 2017/18 accounts of £53,051,000 adjusted for parish precepts; pension interest and asset returns; and investment property expenditure.</p> <p>We consider Gross Revenue Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £51,000 (2017/18: £53,000).

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits: Substantive testing.
- ▶ Related party transactions. Substantive testing.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

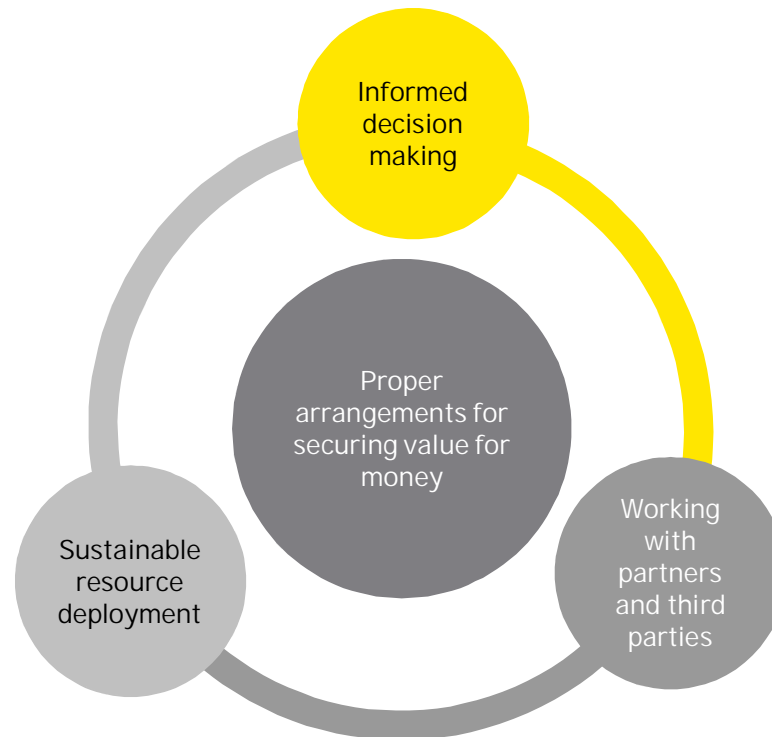


04 Value for Money

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

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.



We did not identify any significant risks in relation to these criteria.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.



05 Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

The Council is below the specified audit threshold of £500mn. Therefore, we were not required to perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2018/19 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 23 July 2019. 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 regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. 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 identified during our audit.

We have adopted a fully substantive audit approach and have therefore not tested the operation of controls.



06 Data Analytics



Use of Data Analytics in the Audit

▶ Data analytics

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2018/19, our use of these analysers in the authority's audit included testing journal entries, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis

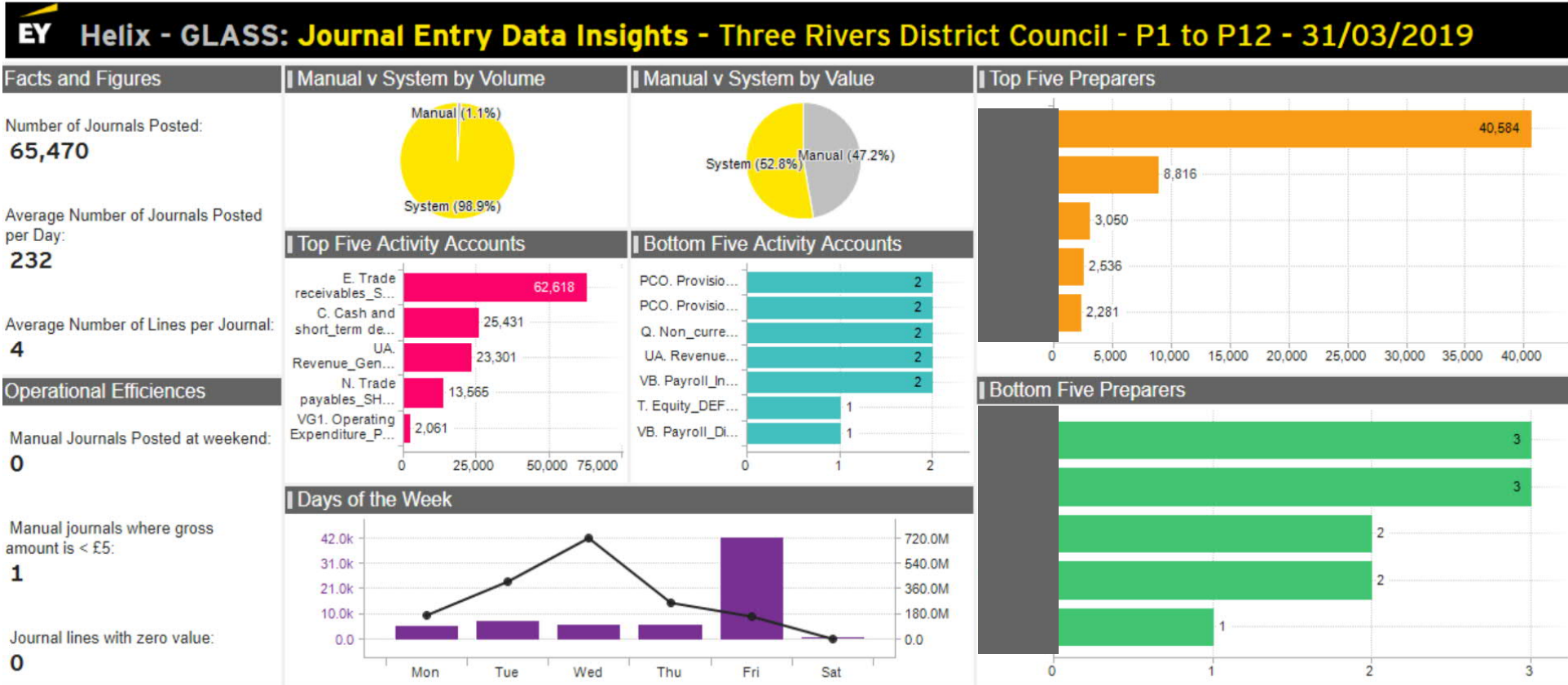
We obtain downloads of all financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.



Journal Entry Data Insights

The graphic outlined below summarises the journal population for 2018/19. We review journals by certain risk based criteria to focus on higher risk transactions, such as journals posted manually by management, those posted around the year-end, those with unusual debit and credit relationships, and those posted by individuals we would not expect to be entering transactions.

The purpose of this approach is to provide a more effective, risk focused approach to auditing journal entries, minimising the burden of compliance on management by minimising randomly selected samples.



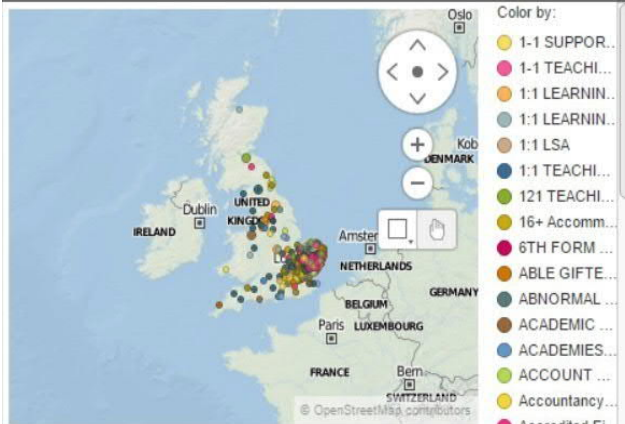
Data Analytics (cont'd)

Payroll Analyser Insights

The graphic outlined below summarises the payroll data for 2018/19. We review transactions for payroll at a more granular level, which allows us to identify items with a higher likelihood of containing material misstatements or to identify unusual patterns within a population of data and to design tests of details. This allows us to provide a more effective and risk focused audit on payroll, improving efficiency for both audit and the management as we reduce the need for evidence support for larger random sample.

EY Helix - Payroll Analyser: 1. Payroll Overview

1.0 Pay Distribution by Location



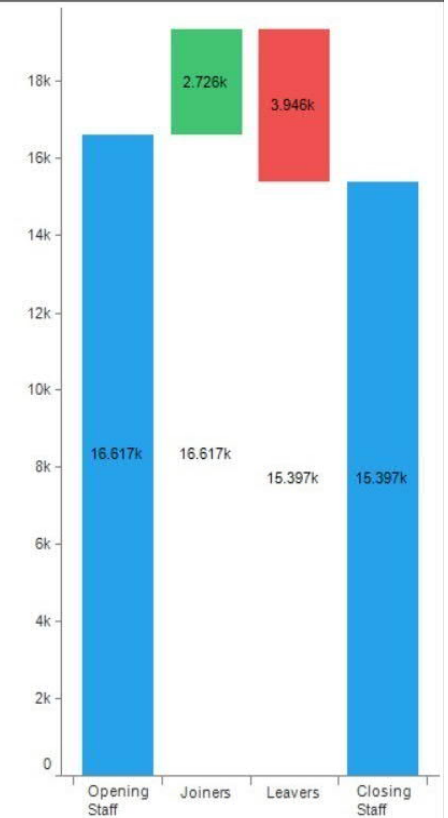
1.2 Transaction Summary

Column	Value	% of Gross
Basic Pay	255.6M	90.7%
Overtime	(Empty)	(Empty)
Holiday pay	(Empty)	(Empty)
Bonuses	(Empty)	(Empty)
Other gross 1	26.2M	9.3%
Other gross 2	(Empty)	(Empty)
Other gross 3	(Empty)	(Empty)
Gross Pay	281.8M	100.0%
Net Pay	211.2M	75.0%
PAYE	27.5M	9.8%
Employee NI	19.3M	6.8%
Employer NI	23.4M	8.3%
Employee Pension	20.1M	7.1%
Employer Pension	56.8M	20.1%
Other	1.9M	0.7%

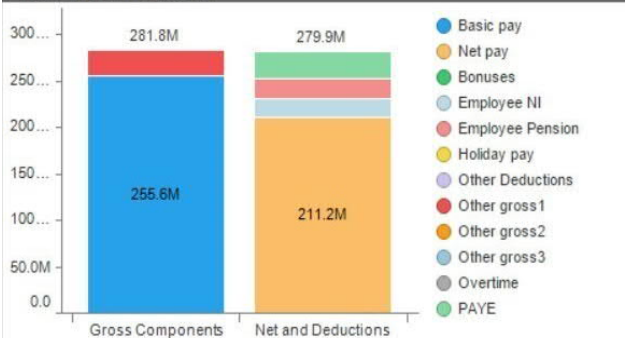
1.3 Data Insights

	Gross	#/%
Staff Turnover		20.40%
Employees not in Master File	537.3k	445
Employees not in Transactions	0.0	141
Payments after Leave Date	1.5M	1,879k
Payments before Join Date	11.9k	9
Largest Gross Payment	55.0k	
Average Gross Payment	1.4k	
Smallest Gross Payment	-39.8k	
Employee(s) under minimum wage		0
Highest Paid Employee : Median Employee		55.01

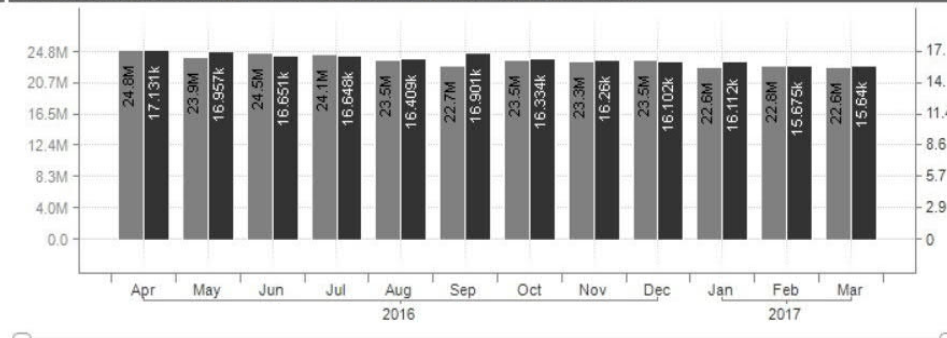
1.5 Employee Movement



1.1 Payroll Summary



1.4 Monthly Trending Analysis of Gross Pay and Employee Count





Journal Entry Testing

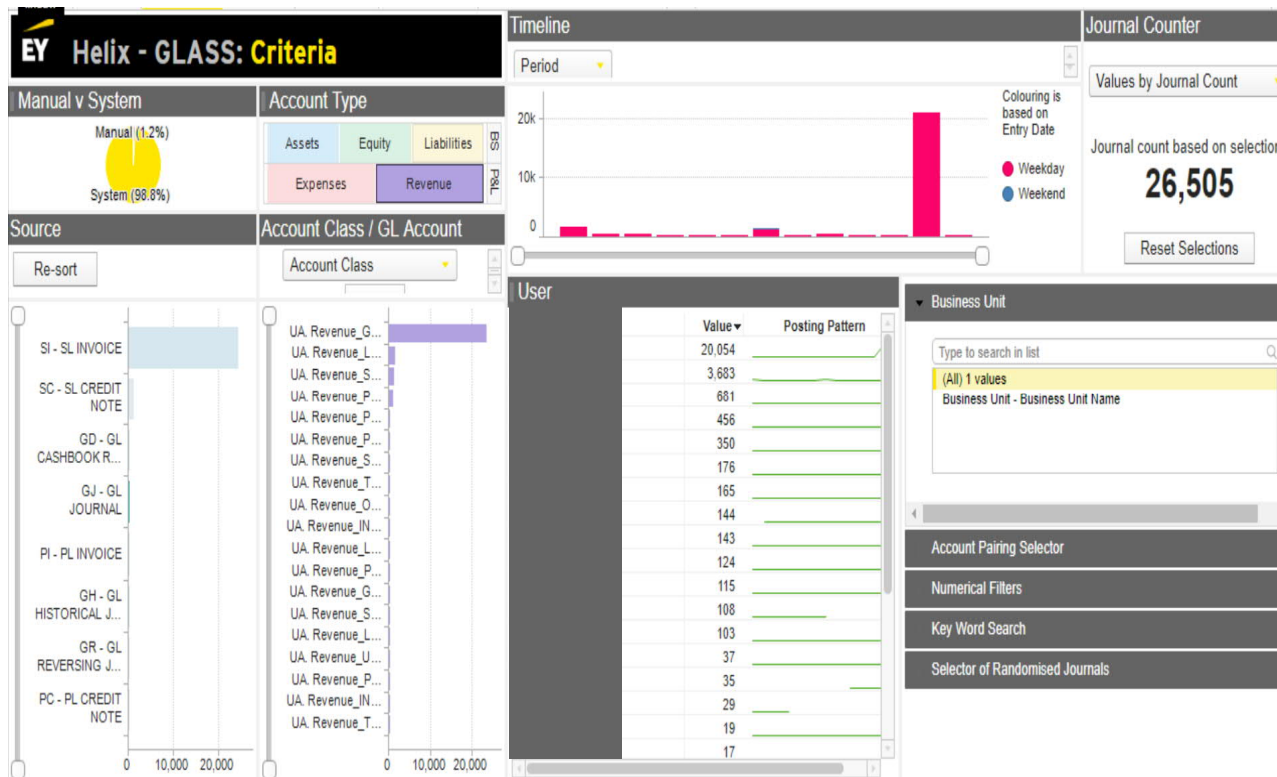
What is the risk?

In line with ISA 240 we are required to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

Journal entry data criteria – 31 March 2019

What judgements are we focused on?

Using our analysers we are able to take a risk based approach to identify journals with a higher risk of management override, as outlined in our audit planning report.



What did we do?

We obtained general ledger journal data for the period and have used our analysers to identify characteristics typically associated with inappropriate journal entries or adjustments, and journals entries that are subject to a higher risk of management override.

We then performed tests on the journals identified to determine if they were appropriate and reasonable.

What are our conclusions?

We isolated a sub set of journals for further investigation and obtained supporting evidence to verify the posting of these transactions and concluded that they were appropriately stated.



07

Focused on your future



Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>
IASB Conceptual Framework	<p>The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>This introduces;</p> <ul style="list-style-type: none"> - new definitions of assets, liabilities, income and expenses - updates for the inclusion of the recognition process and criteria and new provisions on derecognition - enhanced guidance on accounting measurement bases - enhanced objectives for financial reporting and the qualitative aspects of financial information. <p>The conceptual frameworks is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards.</p> <p>However, an understanding of concepts and principles can be helpful to preparers of local authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.</p>	<p>It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements.</p> <p>However, Authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.</p>

A close-up photograph of a person's hand sorting through several manila-colored folders filled with papers. The folders are arranged in a row on a desk. The hand is reaching towards the middle folder, and some papers are slightly fanned out. The background is a light-colored, textured wall.

08 Audit Fees

Independence

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 2019.

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

	Final Fee 2018/19	Planned Fee 2018/19	Scale Fee 2018/19	Final Fee 2017/18
	£	£	£	£
Total Audit Fee – Code work	40,021	40,021	40,021	54,387
Total non- audit services (HB Grant claims)	10,602 plus expenses Then an average of £2,800 plus expenses for each 40+, depending on complexity and resource skills mix	10,602 plus expenses Then an average of £2,800 plus expenses for each 40+, depending on complexity and resource skills mix	10,602 plus expenses Then an average of £2,800 plus expenses for each 40+, depending on complexity and resource skills mix	13,244

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