



LONDON BOROUGH OF BARKING AND DAGENHAM

Audit Progress Report to Audit and Standards Committee

31 January 2020

INTRODUCTION

Background

This report provides the Audit and Standards Committee with an outline of our proposed work and progress to date for 2018/19. Our audit objectives are set out below.

Audit of the financial statements

- to be satisfied that the accounts present a true and fair view; and
- to be satisfied that proper practices have been observed in the preparation of the accounts.

Value for money arrangements

- to be satisfied that the organisation has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources

Reporting

- issue an audit plan that sets out how we intend to carry out our duties;
- report the findings of the audit to those charged with governance;
- to express an opinion on the accounts;
- express a conclusion on the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources; and
- to certify the completion of the audit.

Sampling and materiality

In some areas of the audit our process involves selecting samples to test, using a statistical methodology. If errors are identified in the initial sample, we consider the nature of the error and, where appropriate, select an extended sample for testing to assist with quantification of the misstatement. In some cases we use the results of the sample testing to calculate an error rate which is used to estimate the level of misstatement in the population as a whole and this is reported as an extrapolated misstatement, alongside any factual misstatements identified.

Our consideration of misstatements focuses on their nature and value both individually and cumulatively. In our Audit Plan we set out the materiality levels being applied in this way and have since recalculated them using the draft financial statements provided for audit.

Our materiality level is £11m, misstatements identified that are individually above this level are reported as material misstatements. Our clearly triviality threshold is £220,000, misstatements identified that are below this level are not reported. Misstatements that are between the clearly trivial and material levels are reported as non-trivial. In accordance with auditing standards, we request that the Council correct all non-trivial and material misstatements identified and we report to the Audit and Standards Committee all such misstatements, and whether or not they have been corrected, within our Audit Completion Report at the conclusion of the audit.

SUMMARY

Updated risk assessment

Since issuing our 2018/19 Audit Plan in December 2018, and receiving the Council's draft Statement of Accounts in June 2019, we have updated our planning risk assessment. Our final risk assessment included the following additions to the audit risks reported in the original Audit Plan, the majority of which arose from our comparison of the current year to the prior year accounts where significant movements could not be explained by management:

- Significant risk of material misstatement in respect of:
 - classification of transactions between the Council and its subsidiaries
 - existence and accuracy of short term creditors
 - existence and accuracy of short term debtors
 - accounting treatment of the pension liabilities of staff transferred to the Council's subsidiaries
- Risk of material misstatement in respect of:
 - accounting treatment of prepayments to the pension fund
 - existence and accuracy of schools income and expenditure
 - classification of investments between long and short term
 - opening cash balances
 - re-statement of the Comprehensive Income and Expenditure Account to reflect changes in the Council's management accounting structure.

Our audit response to these risks is set out in the Audit Progress section of this report.




Internal control

Auditing standards require that we report to those charged with governance any significant deficiencies in internal control identified during the audit, in writing, as soon as is practicably possible. Our continuing audit of the draft statement of accounts has identified a significant number of misstatements of the figures contained within them (84 numerical misstatements to date), some materially so. Whilst we are not yet in a position to confirm the net impact of the misstatements on the cost of services reported by the Council, the existence of material misstatements, and the overall number of misstatements identified, led us to conclude that the Council's processes and controls for ensuring a materially accurate draft statement of accounts is produced, were not effective. We consider this a significant deficiency in internal control and reported this matter in a letter to the Chair of the Audit and Standards Committee on 22 October 2019. A copy of the letter is attached to this report as appendix I.

Progress to date and misstatements identified

We continue to work with the finance team on finalising the impact of the audit findings to date, and working toward the Council producing a final set of financial statements that are materially accurate. The latest position regarding misstatements is detailed in appendix II but the final position cannot be confirmed until all our audit work is concluded, in particular the necessary Partner and quality reviewer processes have been concluded and cleared. In addition, the Audit and Standards Committee will also need the opportunity to review the findings and comment on the final version of the financial statements.

We appreciate the co-operation and assistance provided to facilitate the audit so far.

ASSESSMENT		EXPLANATION
RED		Significant number of material issues / errors identified.
AMBER		One material error identified and / or significant number of minor above trivial issues identified.
GREEN		No issues identified

We have completed a significant amount of work in the significant risk areas and this is summarised in the following section along with a ‘RAG’ assessment.

Due to the number of errors identified (84 numerical errors to date) we have also had to perform a significant amount of additional testing to either quantify misstatements or gain assurance of the material accuracy of the balances in the draft financial statements. This includes 9 prior period adjustments agreed with Management as requiring correction and a further 8 potential prior period adjustments which are under discussion at the time of writing. The prior period adjustments relate to areas such as PPE, investments, creditors, debtors and grants.




The resulting additional work is the cause of re-scheduling Partner and Quality Reviewer reviews to later dates.


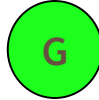



To date our work has not identified any issues which would result in a qualification of the audit opinion, assuming that material and non-trivial misstatements already reported are corrected in the final version of the statement of accounts to the extent that any uncorrected misstatement are not individually or cumulatively material to the financial statements and considered to be appropriate. However, we will conclude on this matter once the audit is complete, at which time we will also issue our Audit Completion Report to those charged with governance.





Fees




The significant amount of additional work that has been necessary as a result of the audit risk profile of the Council, the volume and nature of misstatements identified, the technical issues presented by some of the Council’s arrangements (in particular with respect to group accounting) and the increased level of senior team input required as a result, has a fee implication. We will discuss this with the Deputy Chief Executive, the Council’s Section 151 Officer, once the audit is concluded. Any proposed additional audit fees will also be subject to approval by Public Sector Audit Appointments Limited. Final fees will be reported to the Audit and Standards Committee in due course.

AUDIT PROGRESS 2018/19


AUDIT AREA	PROGRESS	ASSESSMENT OF MISSTATEMENTS
FINANCIAL STATEMENTS (Significant risks identified in audit plan)		
Management override of controls	<p>We have completed a significant amount of work in this area including:</p> <ul style="list-style-type: none"> • sample testing of journals; • review of accounting estimates for bias; and • rationale for any significant business transactions. 	
Revenue and expenditure recognition	<p>We have identified a number of errors in relation to accounting estimates (i.e. accruals and prepayments) from the work completed to date, however there is no indication that these are as a result of any management bias.</p> <p>We have completed a significant amount of work in this area including:</p> <ul style="list-style-type: none"> • sample testing grants to confirm they have been correctly included within the financial statements and have met grant conditions where applicable; • sample testing rental income to ensure the income has been recorded within the correct period; • sample testing expenditure to confirm the transactions have been recorded within the correct period; and • all expected transactions have been recognised. <p>To date we have identified a significant number of errors in relation to the above, including potential material amendments in relation to grant income.</p> <p>We have also identified non trivial errors in relation to income not being included in the correct period.</p>	
Non-current asset valuations	<p>We have completed a significant amount of work in this area including:</p> <ul style="list-style-type: none"> • reviewing the instructions provided to the valuer; • reviewing the assumptions used; • reviewing the accounting treatment and how the draft financial statements have been updated to reflect valuation changes; <p>To date we have identified a number of errors including one material error and a number of non-trivial errors in relation to the work completed in this area. This has been detailed in the misstatements below.</p> <p>Our work in this area is complete, subject to Partner level reviews.</p>	

Group accounts	<p>As part of our work we:</p> <ul style="list-style-type: none"> • had discussions with the Council to understand the approach they had taken to consolidate the accounts; • reviewed the Council’s consideration of IFRS 10 and 12; and • performed audit testing of the consolidated balances on the draft financial statements. <p>Our work has identified a number of errors which has resulted in the Council reviewing and re-issuing their group accounts for audit.</p>	
Pension liability assumption	<p>As part of our work we have:</p> <ul style="list-style-type: none"> • agreed the information provided to the actuary; • assessed the consultancy actuary report; and • tested the controls over the accuracy and completeness of information provided to the actuary. <p>We have not identified any significant issues in this area.</p> <p>Our work in this area is complete, subject to Partner level reviews.</p>	
Expenditure cut-off	<p>Our testing of expenditure to confirm it has been accounted for in the correct period has identified two errors. These are not material.</p>	
New significant risks in relation to audit works		
Creditors	<p>Our initial analytical review identified a material reduction in short term creditors. Further investigation identified that one of the reasons was due to a significant error within the prior year figure where purchase orders were not matched correctly to invoices. This and the issues noted below have led to the material accuracy of creditors being a significant audit risk for 2018/19.</p> <p>Our work has identified a significant number of non-material (above trivial) errors which has resulted in the Council completing a review of their creditor balances and updated working papers provided for audit.</p> <p>To date we have identified a significant number of errors which has resulted in additional audit testing. All errors have been included in the misstatements section below.</p>	
Debtors	<p>Our work has identified a significant number of non-material (above trivial) errors which has resulted in the Council completing a review of their debtor balances and updated working papers provided for audit. In total this has resulted in a material change to the debtors figure.</p> <p>To date we have identified a significant number of errors which has resulted in additional audit testing to be completed. All errors have been included in the misstatements section below.</p>	

Misclassification between entities	<p>Our work on reviewing the coding of transactions between the Council and the various entities it has an interest in has not identified any significant issues. Our work in this area included:</p> <ul style="list-style-type: none"> • Liaising with the outgoing auditor of Be First and reviewing their audit file to understand the issue they identified; • Review of the Council's paper demonstrating that it was able to identify all miscoded transactions in 2017/18 and that it has mitigated the risk of this error repeating in 2018/19; and • Reviewed and tested the operating effectiveness of controls in place to prevent this issue from occurring and considered the implications on our audit strategy if these controls were not effectively designed or operating. <p>Our work in this area is complete, subject to Partner level reviews.</p>	
Other areas to note (Risk of material misstatements)		
PPE - other areas	<p>Our work has identified a number of errors which has resulted in additional sample testing to confirm the accuracy of the balance in the draft financial statements. These include:</p> <ul style="list-style-type: none"> • additions; • Asset under construction; and • Community assets. <p>To date we have identified two potential material errors and a small number of non-trivial errors. These have been detailed in the misstatements section below.</p>	
Consideration of related party transactions	<p>Our work has not identified any significant issues in relation to related party transactions. Our work in this area included:</p> <ul style="list-style-type: none"> • Gaining an understanding of the related party transactions identification procedures in place; • The review of relevant information concerning any such identified transactions; • Review of senior management declarations to ensure there are no potential related party transactions which have not been disclosed; • Companies House searches for any potential undisclosed interests; and • Review of supplier's lists and expenditure items selected in our testing. <p>Our work in this area is complete, and subject to Partner review.</p>	
New accounting standards	<p>Two new accounting standards apply for the 2018/19 accounts, these are IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers.</p> <p>We are currently reviewing the Council's consideration of what the impact of these standards will be on their accounts.</p>	

Allowance for non-collection of receivables	<p>We reviewed the provision model for significant income streams and assessed debtor balances to confirm whether it appropriately reflected historical collection rates by age of debt or arrears.</p> <p>We identified one non-material error in relation to the work completed.</p> <p>Our work in this area is complete, subject to Partner level reviews.</p>	
Componentisation of Council Dwellings	<p>We reviewed:</p> <ul style="list-style-type: none"> • The reasonableness of the split in value between land and building using comparatives from other local authorities. • Considered if a lack of componentisation of buildings resulted in a material misstatement to the depreciation charge. <p>We did not identify any significant issues in relation to componentisation of Council Dwellings.</p> <p>Our work in this area is complete, subject to Partner level reviews.</p>	
Overall information provided including consistency and quality of working papers	<p>Our work through the audit has identified a higher than usual number of errors being identified in the draft financial statements. These include:</p> <ul style="list-style-type: none"> • working papers not agreeing to draft financial statements; • working papers not clearly linking to samples selected; • updated working papers continuing to contain errors resulting in further iterations being required in a number of instances; and • lead time to provide information to auditors slower than initially agreed. <p>We have also provided the Audit and Standards Committee with an ISA 265 Letter due to the number of errors identified in the production of the draft financial statements which indicates a significant weakness in the internal controls over the preparation of financial statements that are materially accurate and compliant with the Code of Practice on Local Authority Accounting.</p>	


AUDIT PROGRESS 2018/19

AUDIT AREA	PROGRESS	ASSESSMENT
Use of Resources		
Sustainable resource deployment	<p>We have completed our initial reviews of the Council's arrangements as part of our initial planning to inform our risk assessment process.</p> <p>To date we have not identified any issues in relation to sustainable resource deployment.</p> <p>We are currently reviewing informed decision making, which will be concluded on once our work on the main audit is complete. We note to date that there is a risk that any decisions made based on financial information are not informed, as our audit indicates that financial information is of a poor quality.</p>	

List of misstatements

We have provided a list of the errors identified to date, which are split between numerical and narrative. Due to the volume of errors identified in debtors and creditors two sub tables have been provided which detail the value of the errors and the potential further impact of the errors identified once additional testing was completed. See Appendix II

The Council are currently working towards reducing the total impact of uncorrected errors to below materiality.



The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the organisation and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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