Grant Thornton

External Audit Plan

Year ending 31 March 2020

Westminster City Council Council and Westminster City Council Pension Fund

January 2020

Contents

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1. Introduction & headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of the Westminster City Council (the Council') and the Westminster City Council Pension Fund ('the Fund') for those charged with governance.

Respective responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of the Council and the Fund. We draw your attention to both of these documents on the PSAA website.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on:

- The Council, Group and Fund's financial statements that have been prepared by management with the oversight of those charged with governance (the Audit and Performance Committee); and
- Value for Money arrangements in place at the Council for securing economy, efficiency and effectiveness in your use of resources.

The audit of the financial statements does not relieve management or the Audit and Performance Committee of your responsibilities. It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the Council's business and is risk based.

Group Accounts	You are required to prepare group financial statements that consolidate the financial information of Westminster Community Homes Ltd, WestCo Trading Limited, Westminster Procurement Services Limited, Soho Create Limited, Hub Make Lab CIC, Paddington Recreation Ground Charitable Trust, Westminster Housing Investments Limited and Westminster Housing Development Limited.
Significant risks	Those risks requiring special audit consideration and procedures to address the likelihood of a material financial statement error have been identified as: **Westminster City Council** • Management override of controls. • Valuation of property, plant and equipment being materially misstated. • Valuation of pension fund net liability being materially misstated. • Appropriateness of the Council's appeals provision for National Non-Domestic Rates (Business Rates). **Westminster Pension Fund** • Management override of controls. • The valuation of Level 3 investment assets being materially misstated. We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings (ISA 260) Report.

1. Introduction & headlines continued

Materiality - Council	We have determined planning materiality to be £15.4m for the group (PY £19.9m) and £15m for the Council (PY £19.8m), which equates to 1.46% of your prior year gross expenditure. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £750k (PY £990k).
Materiality – Pension Fund	We have determined materiality at the planning stage of our audit to be £14.1m (PY £14.1m) for the Fund, which equates to 1% of your net assets for the year. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £709k (PY £709k).
Value for Money arrangements	Our risk assessment regarding your arrangements to secure value for money have identified the following VFM significant risk: • Management of the Council's significant capital projects.
Audit logistics	Our interim visit will take place in March 2020 and our final visit will take place in April and May 2020. Our key deliverables are this Audit Plan and our Audit Findings Report.
Independence	We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

2. Key matters impacting our audit

Factors

The wider economy and the Council's financial position

The challenging financial climate resulting from year on year funding reductions, increased demands for services and wider macro uncertainty has continued to adversely impact Local Government. The Council has identified final gross savings of £36m for 2019/20 to ensure a balanced budget. The proposed savings are from measures which avoid service reductions and come instead from efficiencies, transformation and additional income generation, including a modest increase to Council Tax.

The Council is well placed to meet its future financial challenges if management action on budget proposals continues as currently envisaged and planned. The Council continue to manage its finances well and as at month 6, are reporting a net General Fund underspend of £1.088m against budget with net risks of £1.816m. These continue to be monitored closely as the year progresses.

From 2020/21, the Council will face much wider financial uncertainty. Under the Government's current plans to reform Local Government funding, the Council faces potential risks from a reduction in funding from the next stage of Business Rates Retention, the Government's Spending Review and Fair Funding Review. The Council will need to re-model their future finances following the outcome of this review.

Financial reporting and audit – raising the bar

The Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge, and to undertake more robust testing as detailed in Appendix 1. Our work in 2018/19 has highlighted areas where local government financial reporting, in particular, property, plant and equipment and pensions, needs to be improved, with a corresponding increase in audit procedures. We have also identified an increase in the complexity of local government financial transactions which require greater audit scrutiny.

From 1 April 2020 the Council will need to implement the new leases accounting standard (IFRS16). This has the potential for more assets and associated liabilities to be bought onto the Council's balance sheet.

Your future plans

The Council has recently published a draft City Plan 2019-2040 setting out your vision and strategy for the development of the city. The plan includes a housing target of 1,495 new homes per year (first ten years of this Plan). The Council are also investing £150 million over the next three years to deliver the ambitious Oxford Street District Place Strategy. This includes more than 90 projects aimed at improving and enhancing the whole district, including its residential neighbourhoods, while securing its future as a global destination, with an unrivalled experience for visitors.

The Council are involved in new and innovative projects with partners that will help to finance and deliver the plan. The Council will need to ensure that the accounting arrangements are agreed and set out in advance including assessing the potential implications on the Council's Group Accounts.

Brexit

With the UK due to leave the European Union on 31 January 2020, there will be national and local implications resulting from Brexit that will impact on the Council. The Council will need to review their workforce plans, analyse their supply chains and model potential impacts on Council finances including investment and borrowing as well as any potential impact on the valuation of Council and Pension Fund assets.

Our response

We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting. Our proposed work and fee, as set out further on in our Audit Plan, has been agreed with the Executive Director of Finance and Resources and is subject to PSAA agreement.

We will review your proposed technical accounting treatments for projects in advance of you preparing your financial statements.

We will assess the adequacy of your disclosure about the financial impact of implementing IFRS 16 – Leases from 1 April 2020 and test a sample of lease obligations to determine whether they have been accounted for appropriately under the new requirements.

3. Group audit scope and risk assessment

In accordance with ISA (UK) 600, as group auditor we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Component	Individually Significant?	Audit Scope	Risks identified	Planned audit approach
Westminster City Council	Yes		See detail on pages 7-9	Full scope UK statutory audit performed by Grant Thornton UK LLP
Westminster Community Homes Limited	No		Valuation of property, plant and equipment	Audit or one or more classes of transactions, account balances or disclosures relating to significant risks of material misstatement of the group financial statements.
WestCo Trading Limited Westminster Procurement Services Limited Soho Create Limited Hub Make Lab CIC Paddington Recreational Ground Trust Westminster Housing Investments Limited Westminster Housing Development Limited	No		None	Analytical review performed by Grant Thornton UK LLP.

Audit scope

- Audit of the financial information of the component using component materiality
- Audit of one more classes of transactions, account balances or disclosures relating to significant risks of material misstatement of the group financial statements
- Review of component's financial information
- Specified audit procedures relating to significant risks of material misstatement of the group financial statements
- Analytical procedures at group level

4. Significant risks identified

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Fraudulent revenue and expenditure recognition	**Council, Group and Fund**	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • There is little incentive to manipulate revenue recognition. • Opportunities to manipulate revenue recognition are very limited. • The culture and ethical frameworks of local authorities, including the Council and Fund, mean that all forms of fraud are seen as unacceptable. Therefore, we do not consider this to be a significant risk for you. In addition, in accordance with PN10, the audit team have considered the risk of fraudulent manipulation of expenditure. We do not consider that this is a significant risk for yourselves, after consideration of the following: • The staff preparing and approving the accounts are consistent with those in previous years. • There have been no changes in accounting processes and controls in the year. • There have been no significant unexplained movements in funding/outturn position. • There have been no changes in the methodology for calculation of estimates. • There have been no instances of year-end adjustments being posted by a senior finance officer without independent authorisation. We will check for any postings by senior finance officers as part of our journals testing.

4. Significant risks identified continued

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Management over-ride of controls	**Council, Group and Fund**	Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement. The main mechanism through which this could occur is through the posting of manual journals amending the reported financial performance. We therefore review the controls established relating to manual journals, including those for authorisation of manual journals.	We will: • Evaluate the design effectiveness of management controls over journals. • Analyse the journals listing and determine the criteria for selecting high risk unusual journals. • Test unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration. • Gain an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence. • Evaluate the rationale for any changes in accounting policies, estimates or significant unusual transactions.
Valuation of property, plant and equipment being materially misstated	**Council and Group**	The Council revalues land and buildings on an annual basis to ensure that the carrying value is not materially different from the current value or fair value (for surplus assets) at the financial statements date. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£2.5bn) and the sensitivity of this estimate to changes in key assumptions. Management have engaged the services of an internal valuer to estimate the current value as at 31 March 2020. We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.	We will: • Evaluate management's processes and assumptions for the calculation of the estimate, the instructions issued to the valuation experts and the scope of their work. • Evaluate the competence, capabilities and objectivity of the valuation expert. • Write to the valuer to confirm the basis on which the valuations were carried out. • Challenge the information and assumptions used by the valuer to assess completeness and consistency with our understanding. • **Utilise our own valuer to challenge your assumptions and methodologies applied in the valuation**. • Test, on a sample basis, revaluations made during the year to ensure they have been input correctly into your asset register. • Evaluate the assumptions made by management for any assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value.

4. Significant risks identified continued

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of the pension fund net liability	**Council and Group**	The Council's pension fund net liability, as reflected in the balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements and group accounts. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£702 million in the balance sheet) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • Update our understanding of the processes and controls put in place by management to ensure that the pension fund net liability is not materially misstated and evaluate the design of the associated controls. • Evaluate the instructions issued by management to your management expert (an actuary) for this estimate and the scope of the actuary's work. • Assess the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation. • Assess the accuracy and completeness of the information you provided to the actuary to estimate the liability. • Test the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary. • Undertake procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report.
Appeals Provision for National Non-Domestic Rates (Business Rates)	**Council**	The Council's provision for business rates appeals remains the largest in the country and is a highly material balance in the financial statements. The provision is based on significant judgements made by management and uses a complex estimation technique to prepare the provision.	We will: • Monitor how the appeals process is affecting the Council and any planned changes in the methodology used to calculate the provision. • Identify the controls put in place by management to ensure that the appeals provision is not materially misstated. We will also assess whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement. • Review assumptions made by management and the processes in calculating the estimate. • Test the calculation and its agreement to supporting documentation. • Review the disclosures made by the Council in the financial statements.

4. Significant risks identified continued

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of Level 3 Investments	**Fund**	By their nature, Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved (£77 million) and the sensitivity of this estimate to changes in key assumptions Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end. Management utilise the services of investment managers as valuation experts to estimate the fair value as at 31 March 2020. We therefore identified valuation of Level 3 investments as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • Gain an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls. • Review the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments to ensure that the requirements of the Code are met. • Consideration of the competence, expertise and objectivity of any management experts used. • Review the qualification of the expert used to value Level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached. • For a sample of investments, test the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconcile those values to the values at 31 March 2020 with reference to known movements in the intervening period.

We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings Report in May 2020.

5. Other risks identified

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
International Financial Reporting Standard (IFRS) 16 Leases **(issued but not adopted)**	**Council and Group**	The public sector will implement this standard from 1 April 2020. It will replace IAS 17 Leases, and the three interpretations that supported its application (IFRIC 4, Determining whether an Arrangement contains a Lease, SIC-15, Operating Leases – Incentives, and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease). Under the new standard the current distinction between operating and finance leases is removed for lessees and, subject to certain exceptions, lessees will recognise all leases on their balance sheet as a right of use asset and a liability to make the lease payments. In accordance with IAS 8 and paragraph 3.3.4.3 of the Code disclosures of the expected impact of IFRS 16 should be included in the Authority's 2019/20 financial statements. The Code adapts IFRS 16 and requires that the subsequent measurement of the right of use asset where the underlying asset is an item of property, plant and equipment is measured in accordance with section 4.1 of the Code.	We will: • Evaluate the processes the Council has adopted to assess the impact of IFRS16 on its 2020/21 financial statements and whether the estimated impact on assets, liabilities and reserves has been disclosed in the 2019/20 financial statements. • Assess the completeness of the disclosures made by the Council in its 2019/20 financial statements with reference to The Code and CIPFA/LASAAC Local Authority Leasing Briefings.

6. Other matters

Other work

In addition to our responsibilities under the Code of Practice, we have a number of other audit responsibilities, as follows:

- We read your Narrative Report and Annual Governance Statement and any other information published alongside your financial statements to check that they are consistent with the financial statements on which we give an opinion and consistent with our knowledge of the Authority
- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with the guidance issued by CIPFA
- We carry out work on your consolidation schedules for the Whole of Government Accounts process in accordance with NAO group audit instructions
- We consider our other duties under the Local Audit and Accountability Act 2014 (the Act) and the Code, as and when required, including:
    - Giving electors the opportunity to raise questions about your 2019/20 financial statements, consider and decide upon any objections received in relation to the 2019/20 financial statements.
    - Issue of a report in the public interest or written recommendations to the Authority under section 24 of the Act, copied to the Secretary of State.
    - Application to the court for a declaration that an item of account is contrary to law under Section 28 or for a judicial review under Section 31 of the Act or
    - Issuing an advisory notice under Section 29 of the Act.
- We certify completion of our audit.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the group, Authority’s and Fund’s ability to continue as a going concern” (ISA (UK) 570). We will review management's assessment of the going concern assumption and material uncertainties, and evaluate the disclosures in the financial statements.

7. Materiality

The concept of materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

Council and Group

We have determined financial statement materiality based on a proportion of the gross expenditure of the Group and Council. In the prior year we used the same benchmark. Materiality at the planning stage of our audit is £15.4m for the Group (PY £19.9m) and £15m for the Council (PY £19.8m), which equates to 1.46% of your prior year gross expenditure.

Pension Fund

We have determined financial statement materiality based on a proportion of the Fund's net assets. In the prior year we used the same benchmark. Our materiality at the planning stage is £14.1.m (PY £14.1m) which equates to 1% of the Fund's actual net assets for the year ended 31 March 2019.

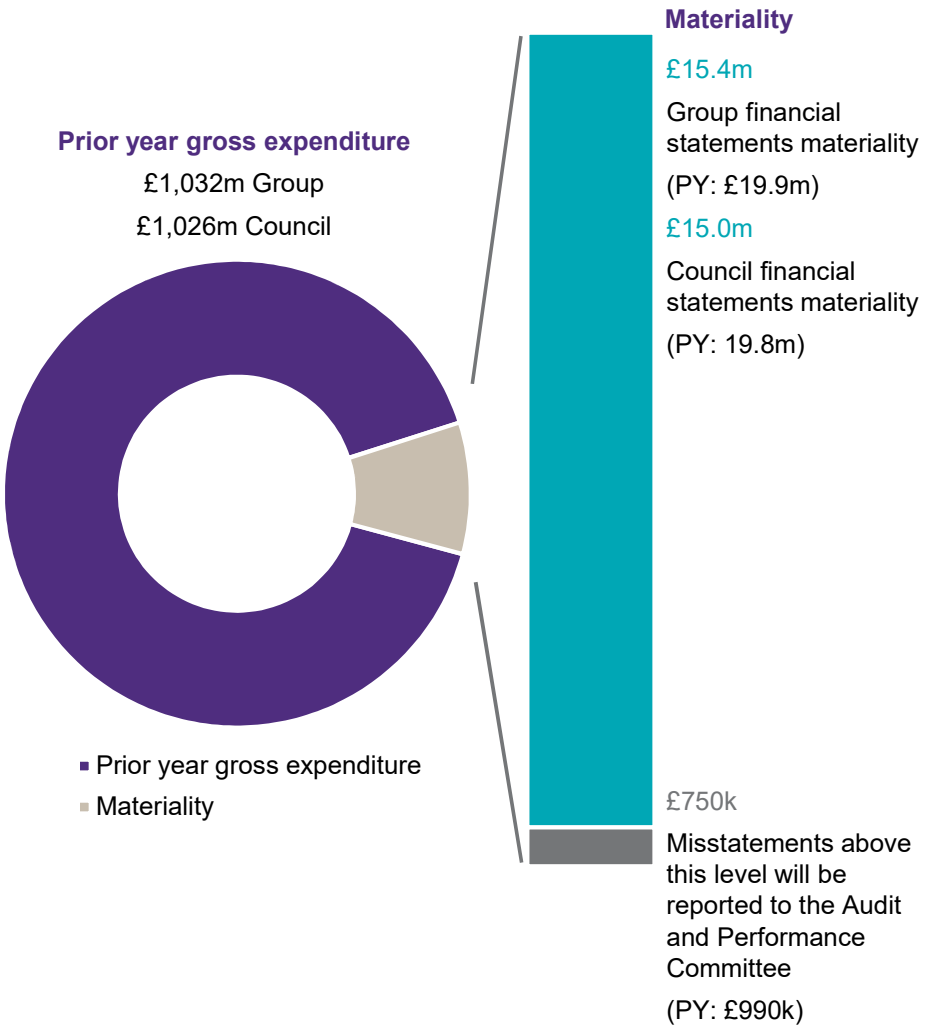
We reconsider planning materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality.

Matters we will report to the Audit and Performance Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Performance Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of the group and Council, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £750k (PY £990k). In the context of the Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £709k (PY £709k).

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Governance Committee to assist it in fulfilling its governance responsibilities.



8. Value for Money arrangements

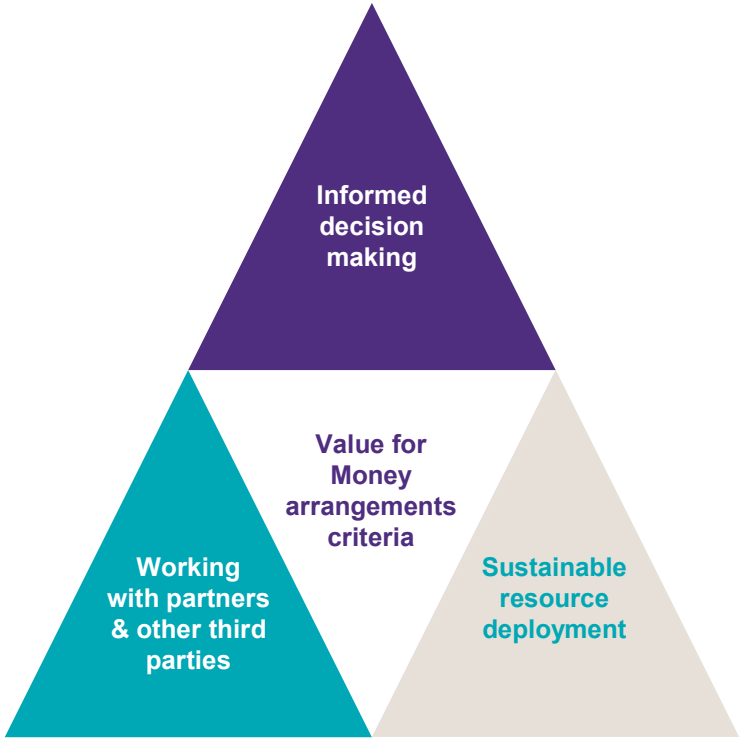
Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work in November 2017. The guidance states that for Local Government bodies, auditors are required to give a conclusion on whether the Authority has proper arrangements in place to secure value for money.

The guidance identifies one single criterion for auditors to evaluate:

"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."

This is supported by three sub-criteria, as set out below:



Significant VFM risks

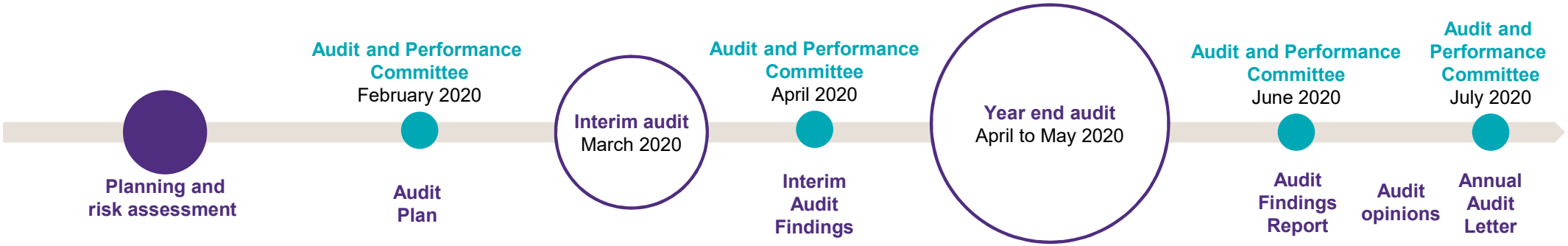
Those risks requiring audit consideration and procedures to address the likelihood that proper arrangements are not in place at the Authority to deliver value for money.

Management of Capital Projects

The Council's capital programme includes a number of key projects and investments, which are significant both in scale and financial terms. The Council recognised that several of these schemes continue to be subject to significant slippage. We will undertake the following work:

- Review the Council's budgeting and timescales for delivery of projects to determine whether these are realistic.
- Review the Council's project management processes that ensure delivery of projects to time and budget.
- Analyse the reasons for slippage and determine whether these are outside of the Council's control.

9. Audit logistics & team



Paul Dossett, Engagement Lead

Paul will be the main point of contact for the Chief Executive, statutory officers and Members. Paul will share his wealth of knowledge and experience across the sector providing challenge, sharing good practice, providing pragmatic solutions and acting as a sounding board with Senior Management and the Audit and Performance Committee. Paul will ensure our audit is tailored specifically to the Council and Fund and is delivered efficiently. Paul will review all reports and the team's work focussing his time on the key audit risks.

Laurelin Griffiths, Council Audit Manager

Laurelin will support Paul in his work to ensure the early delivery of audit testing, but with a focus on issues relating to the Council. She will lead on a number of complex accounting issues. Laurelin will attend Audit and Performance Committee meetings and draft reports, ensuring they remain clear, concise and understandable to all. She will also be responsible for undertaking reviews of the team's work.

Paul Jacklin, Senior Manager

Paul will work with the senior members of the finance and executive teams, ensuring early delivery of testing and agreement of accounting issues on a timely basis. Paul will attend Audit and Performance Committee meetings, undertake reviews of the team's work and draft reports. Paul will work with Internal Audit to secure efficiencies and avoid duplication, providing assurance for the Annual Governance Statement.

Marc Chang, Pension Fund Audit Manager

Marc will be the day to day contact for the Pension Fund audit. Marc will monitor the deliverables, highlight any significant issues and adjustments to senior management, drat reports and review the team's work.

9. Audit logistics & team continued

Client responsibilities

Where clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. Where the elapsed time to complete an audit exceeds that agreed due to a client not meeting its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- Produce draft financial statements of good quality by the deadline you have agreed with us, including all notes, the narrative report and the Annual Governance Statement.
- Ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you.
- Ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples.
- Ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit.
- Respond promptly and adequately to audit queries.

10. Independence & non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons relating to our independence. We encourage you to contact us to discuss these or any other independence issues with us. We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council’s Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office’s Auditor Guidance Note 01 issued in December 2017 and PSAA’s Terms of Appointment which set out supplementary guidance on ethical requirements for auditors of local public bodies.

Appendices

Appendix A: Audit Quality – national context

What has the FRC said about Audit Quality?

The Financial Reporting Council (FRC) publishes an annual Quality Inspection of our firm, alongside our competitors. The Annual Quality Review (AQR) monitors the quality of UK Public Interest Entity audits to promote continuous improvement in audit quality.

All of the major audit firms are subject to an annual review process in which the FRC inspects a small sample of audits performed from each of the firms to see if they fully conform to required standards.

The most recent report, published in July 2019, shows that the results of commercial audits taken across all the firms have worsened this year. The FRC has identified the need for auditors to:

- improve the extent and rigour of challenge of management in areas of judgement
- improve the consistency of audit teams' application of professional scepticism
- strengthen the effectiveness of the audit of revenue
- improve the audit of going concern
- improve the audit of the completeness and evaluation of prior year adjustments.

The FRC has also set all firms the target of achieving a grading of '2a' (limited improvements required) or better on all FTSE 350 audits. We have set ourselves the same target for public sector audits from 2019/20.

Other sector wide reviews

Alongside the FRC, other key stakeholders including the Department for Business, energy and Industrial Strategy (BEIS) have expressed concern about the quality of audit work and the need for improvement. A number of key reviews into the profession have been undertaken or are in progress. These include the review by Sir John Kingman of the Financial Reporting Council (Dec 2018), the review by the Competition and Markets authority of competition within the audit market, the ongoing review by Sir Donald Brydon of external audit, and specifically for public services, the Review by Sir Tony Redmond of local authority financial reporting and external audit. As a firm, we are contributing to all these reviews and keen to be at the forefront of developments and improvements in public audit.

What are we doing to address FRC findings?

In response to the FRC's findings, the firm is responding vigorously and with purpose. As part of our Audit Investment Programme (AIP), we are establishing a new Quality Board, commissioning an independent review of our audit function, and strengthening our senior leadership at the highest levels of the firm, for example through the appointment of Fiona Baldwin as Head of Audit. We are confident these investments will make a real difference.

We have also undertaken a root cause analysis and put in place processes to address the issues raised by the FRC. We have already implemented new training material that will reinforce the need for our engagement teams to challenge management and demonstrate how they have applied professional scepticism as part of the audit. Further guidance on auditing areas such as revenue has also been disseminated to all audit teams and we will continue to evolve our training and review processes on an ongoing basis.

What will be different in this audit?

We will continue working collaboratively with you to deliver the audit to the agreed timetable whilst improving our audit quality. In achieving this you may see, for example, an increased expectation for management to develop properly articulated papers for any new accounting standard, or unusual or complex transactions. In addition, you should expect engagement teams to exercise even greater challenge management in areas that are complex, significant or highly judgmental which may be the case for accounting estimates, going concern, related parties and similar areas. As a result you may find the audit process even more challenging than previous audits. These changes will give the audit committee – which has overall responsibility for governance - and senior management greater confidence that we have delivered a high quality audit and that the financial statements are not materially misstated. Even greater challenge of management will also enable us to provide greater insights into the quality of your finance function and internal control environment and provide those charged with governance confidence that a material misstatement due to fraud will have been detected.

We will still plan for a smooth audit and ensure this is completed to the timetable agreed. However, there may be instances where we may require additional time for both the audit work to be completed to the standard required and to ensure management have appropriate time to consider any matters raised. This may require us to agree with you a delay in signing the announcement and financial statements. To minimise this risk, we will keep you informed of progress and risks to the timetable as the audit progresses.

We are absolutely committed to delivering audit of the highest quality and we should be happy to provide further detail about our improvement plans should you require it.