

14 March 2019

Dear Members of the Audit and Standards Committee,

Audit and Standards Committee - 18 March 2019

I am now able to enclose, for consideration, the following report/s at the above meeting that was/were unavailable when the agenda was printed.

| Item No | Item |
|----------------|-------------|
|----------------|-------------|

| | |
|-----------|---|
| 12 | Planning report for the year ending 31 March 2019 (draft) (Pages 1 - 22) |
|-----------|---|

This is a draft report of Deloitte. Any updates to the report will be addressed at the meeting.

Yours sincerely,

Committee Services
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Planning report to the Audit and Standards Committee for the year ending 31 March 2019

March 2019

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01 Planning report

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Introduction

The key messages in this report:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

We have pleasure in presenting our planning report to the Audit and Standards Committee (the Committee) for the 2019 audit of Lewes District Council (the Council). We would like to draw your attention to the key messages of this paper:

Audit Plan

- We have held an audit handover meeting with BDO LLP and reviewed their audit files and reports.
- We are developing our understanding of the Council through discussion with management and review of relevant documentation from across the Council.
- Based on these procedures, we have developed this plan to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the users of the Council's statement of accounts.

Key risks

- We have taken an initial view as to the significant audit risks that the Council faces. These are presented on page 11 onwards.

Regulatory change

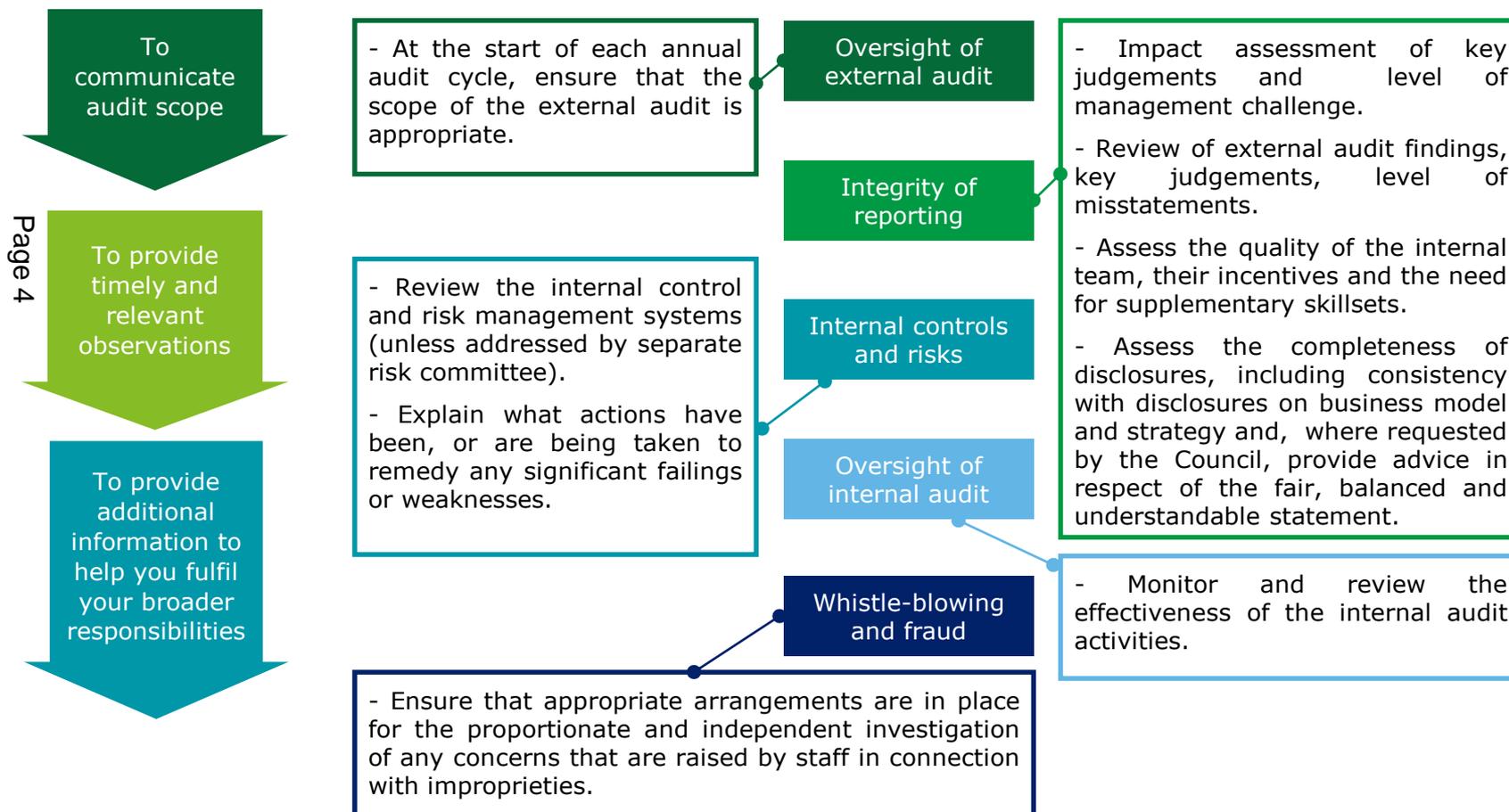
- Our audit is carried out under the Code of Audit Practice issued by the National Audit Office (NAO).
 - We will update Management and the Committee with sector and technical updates as they arise.
-

Responsibilities of the Audit and Standards Committee

Helping you fulfil your responsibilities

Why do we interact with the Audit and Standards Committee?

As a result of regulatory change in recent years, the role of the Audit and Standards Committee has significantly expanded. We set out here a summary of the core areas of Audit and Standards Committee responsibility to provide a reference in respect of these broader responsibilities.



Our audit explained

We tailor our audit to your Council and your strategy

Identify changes in your Council and environment.

We have spent time understanding the current year matters and prepared our risk assessment for the audit, we will continue to keep this under review throughout the audit process.

During the year the Council has progressed with a number of commercial transactions and developments including:

- Regeneration of Newhaven town centre;
- North Street Quarter development; and
- Clear Futures Joint Venture.

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Scoping

We anticipate our scope to be in line with the Code of Audit Practice issued by the NAO.

We will not scope out any significant items or items that would have a material impact on the financial statements.

In our final report

In our final report to you we will conclude on the significant audit risks identified in this paper and report to you our other findings.



Determine materiality

We have determined materiality of £1.8m. This is based on 2% of gross expenditure of the prior years audited financial statements. We will report to you any misstatements above £90k. We will report to you misstatements below this threshold if we consider them to be material by nature. For further detail on materiality see page 9.

Significant risk assessment

We will identify significant audit risks in relation to the Council and plan our audit response to meet these risks (Page 11 onwards).

Quality and Independence

We confirm all Deloitte network firms are independent of the Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Scope of work and approach

We have the following key areas of responsibility under the Audit Code of Practice

Financial statements

We will conduct our audit in accordance with International Standards on Auditing (UK) ("ISA UK") as adopted by the UK Auditing Practices Board ("APB") and Code of Audit Practice issued by the NAO. The Council will prepare its accounts under the Code of Practice on Local Council Accounting ("the Code") issued by CIPFA and Local Authority (Scotland) Accounts Authority Committee (LASAAC).

We are also required to issue a separate assurance report to the NAO on the Council's separate return required for the purposes of its audit of the Whole of Government Accounts and departmental accounts.

Annual Governance Statement

We are required to consider the completeness of the disclosures in the Annual Governance Statement in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and other work.

As part of our work we will review the annual report and compare with other available information to ensure there are no material inconsistencies. We will also review any reports from other relevant regulatory bodies and any related action plans developed by the Council.

Value for Money conclusion

We are required to satisfy ourselves that the Council has made proper arrangements for securing financial resilience and economy, efficiency and effectiveness in its use of resources.

To perform this work, we are required to:

- plan our work based on consideration of the significant risks of giving a wrong conclusion; and
- carry out as much work as is appropriate to enable us to give a safe conclusion on the arrangements to secure VFM.

Our work therefore includes a detailed risk assessment based on the risk factors identified in the course of our audits. This is followed by specific work focussed on the risks identified.

We have identified that the Council has a number of transformational projects which include town centre and housing redevelopments. Given the savings identified in the Medium Term Financial Strategy (MTFS) 2020/2021 and future funding cuts we have identified these transformation projects as an area of audit interest in relation to the Council securing financial resilience and effectiveness in its use of resources as there is a risk that the developments may not be securing value for money for the taxpayer's of Lewes District as well as posing a risk to the Council achieving its projected and required efficiencies.

We will undertake a more detailed assessment of risk during our interim work where we will review the Council's MTFS and hold further discussions with management and we will then provide a conclusion on these arrangements as part of our final reporting to you.

Whole Government Accounts

The council is not expected to be in scope for audit work.

If the council is over the threshold when instructions from NAO are released then our work on the Whole of Government Accounts return is carried out in accordance with instructions and typically focuses on testing the consistency of the return with the Council's financial statements, together with the validity, accuracy and completeness of additional information about the Council's transaction and balances with other bodies consolidated within the Whole of Government Accounts. We are also typically asked to report to the NAO on key findings from our audit of the accounts. The NAO has not yet issued its instructions for the current year.

Scope of work and approach

Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA UK 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them where necessary to discuss their work. We will review the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit where necessary to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

The results of our work in obtaining an understanding of controls will be collated and the impact on the extent of substantive audit testing required will be considered.



Our responsibilities as auditor, and the responsibilities of the Council, are set out in "PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies", published by PSAA

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Council complete the Code checklist during drafting of their financial statements.

We would welcome the opportunity to review a skeleton set of financial statements and an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management.

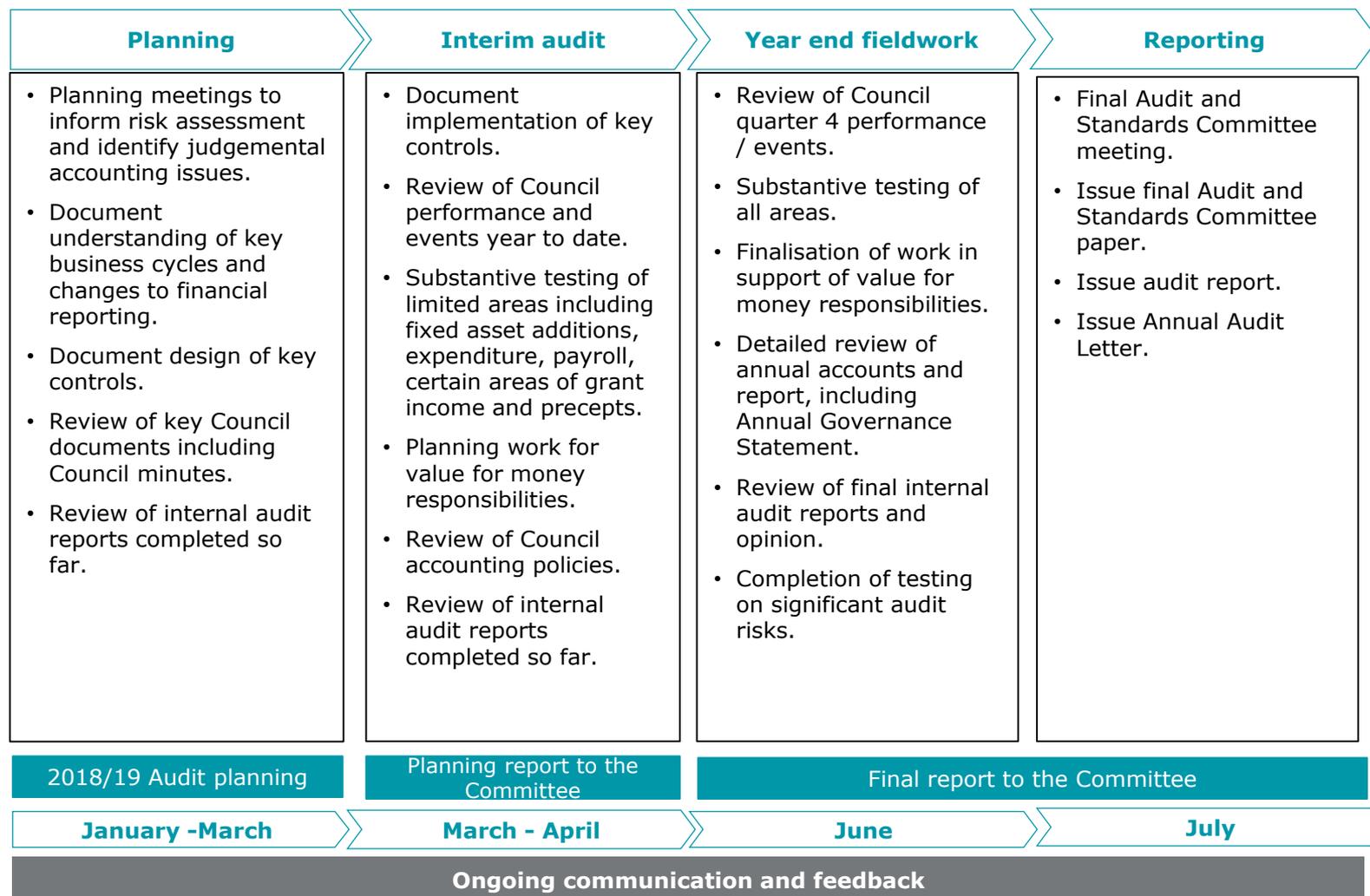
Value for Money and other reporting

The Code of Audit Practice requires us to report by exception in our audit report any matters that we identify that indicate the Council has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Continuous communication and reporting

Planned timing of the audit

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Materiality

Our approach to materiality

Basis of our materiality benchmark

- The audit lead has determined materiality as £1.8m based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of Gross Expenditure up to the surplus/deficit on provision of services based on the 2017/18 audited accounts as the benchmark for determining materiality.
- We will assess the Council materiality at interim and re-assess materiality according to the year-end position.
- Note, as the Council's components are not consolidated we will not calculate a separate group materiality.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £90k.
- We will report to you misstatements below this threshold if we consider them to be material by nature.

Although materiality is the judgement of the audit lead, the Audit and Standards Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements; and
- the Council's actual and planned performance on financial and other relevant metrics.

Principal risk and uncertainties

- Future levels of government funding

IAS 1 Critical accounting estimates

- Pension liability
- Impairment of doubtful debts
- Useful lives of assets
- Investment property
- Provisions

Changes in your business and environment

- During 2017/18 the Council engaged in a Joint Transformation Programme (JTP) with Eastbourne Borough Council under which staff and services were integrated.
- Progression of the developments and commercial transactions underway at the Council, including:
 - Regeneration of Newhaven town centre;
 - North Street Quarter development; and
 - Clear Futures Joint Venture.
- In addition, 2018/19 will also be the first financial period that the Authority will adopt both International Financial Reporting Standards 9 and 15 (Financial Instruments and Revenue from Contracts with Customers respectively).
- Finally, the Council will need to consider the impacts of Britain's exit from the European Union when preparing its financial statements.

Significant Audit Risks

Completeness of Expenditure

Risk identified

Under UK auditing standards, there is a presumed risk in respect of revenue recognition due to fraud. We have rebutted this risk, and instead believe that the fraud risk lies with the completeness of expenditure and completeness and valuation of accruals and provisions.

For 2018/19, the Council approved a budget with a net cost of service of £12.2m. As at September 2018, the Council reported a forecast overspend of £19k, but that they are working towards a balanced position which was achieved in 2017/18. Given the Council's current budget position and the pressures across the whole of the public sector, there is an inherent risk that the year-end position could be manipulated by omitting or misstating accruals and provisions.

Our response

Our work in this area will include the following:

- We will obtain an understanding of and test the design and implementation of the key controls in place in relation to recording completeness of accruals and provisions;
 - We will perform focused testing in relation to the completeness of expenditure including a detailed review of accruals and provisions;
 - As part of this focused testing we will challenge any assumptions made in relation to year-end accruals and provisions; and
 - In addition, we will review the year on year movement in accruals and provisions and will investigate any significant downwards movements.
-

Significant Audit Risks

Property Valuation

Risk identified

The Council held £267.2m of property assets (land, buildings and £2m of assets under construction) at 31 March 2017 which increased to £274.6m as at 31 March 2018 of which £0.9m represented assets under construction. The increase was largely due to upwards revaluations as a result of the Council undertaking a desktop valuation exercise during 2017/18.

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council's land and buildings, and Council dwellings, are revalued every five years (with the last full revaluation exercises undertaken on 1 April 2015) with a desktop revaluation review carried out annually to identify any material changes to a class of asset. As a result of this, however, individual assets may not be revalued for up to four years. There is therefore a risk that the carrying value of assets not included in the Council's revaluation process in the current year materially differ from the year end fair value.

In addition, given the material value of the assets there is a risk that the valuation assumptions which are judgemental in nature may be materially misstated.

Further, in 2018/19 the Council will be using a new valuer and there is a risk that there may be a change in the methodology and assumptions used which may give rise to material adjustments.

Our response

We will test the design and implementation of key controls in place around the property valuation and we will understand how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation. In addition, we will assess what valuation assumptions may have been made if there is a time lag between the valuation and the year-end.

We will review any revaluations performed in the year, assessing whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals.

We will use our valuation specialists (Deloitte Real Estate) where considered appropriate, to support our review and challenge the appropriateness of the assumptions used in the year-end valuation of the Council's Land and Buildings.

We will test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts.

Significant Audit Risks

Management Override of Controls

Risk identified

In accordance with ISA 240 (UK) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risks and areas of audit interest: completeness of expenditure, valuation of the Council's estate and pension liability. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Our response

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

- We will test the design and implementation of key controls in place around journal entries and management estimates;
 - We will risk assess journals and select items for detailed testing using data analytics. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest;
 - We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting;
 - We will review accounting estimates for biases that could result in material misstatements due to fraud; and,
 - We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the Council, or that otherwise appear to be unusual, given our understanding of the entity and its environment.
-

Other Areas of Audit Interest

Pensions Liability Valuation

Risk identified The Council are part of the Local Government Pension Scheme administered by East Sussex County Council. The Council recognised a pension liability of £12.1m at 31 March 2017 which decreased to £10.9m as at 31 March 2018. The Code requires that their year end carrying value should reflect the appropriate fair value at that date.

Hymans Robertson act as the Council's expert actuary, who produce a report outlining the liability and disclosures required for each council.

Our response We carry out a separate, detailed risk assessment of each of the individual components of the calculation (for example market assumptions, membership data, assets and liabilities) using a developed methodology which takes into account factors such as an assessment of the actuary. We scope our work, including the nature and extent of our actuarial specialists involvement, in a way which responds to this detailed risk assessment. Should our risk assessment change our overall audit approach in respect of testing pensions, we will notify the Committee.

We will confirm the disclosure of the pension figures in the statement of accounts agree with those provided by the scheme actuary.

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Accounting for commercial transactions

Risk identified The Clear Futures Joint Venture between the Council, Eastbourne Borough Council, AECOM and Robertson potentially has complex accounting and considerations which will be made by management.

Our response We will review management's accounting papers for each transaction, together with supporting transaction documentation, and critically evaluate the appropriateness of the accounting treatment adopted, estimates and judgements used in accounting, and the disclosures made in the financial statements. We will also consider whether any factors identified in our testing impact our value for money risk assessment, discussed further below.

Other areas of audit interest

Value for Money

Risk identified

Under the NAO Code, we are required to report whether, in our opinion: the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The Code and supporting auditor guidance note require us to perform a risk assessment to identify any risks that have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. We are required to carry out further work where we identify a significant risk - if we do not identify any significant risks, there is no requirement to carry out further work.

The Council's MTFS 2020/21 implements a priority based budget system which considers potential future funding cuts and required efficiencies. To achieve these efficiencies the Council has embarked on a JTP with Eastbourne Borough Council and considered in detail the use of current reserves to support the sustainability of the Council. There are however, a significant number of capital developments in the Council's plan which require material investment and there is a risk that efficiency measures may not be effective and that the developments are not delivered in an efficient and financially sustainable manner.

Our response

Our work in this area will include:

- A full understanding of the MTFS and the Council's transformation programmes and the related considerations to achieve value for money;
 - High level interviews with senior operational staff and internal audit as required;
 - Review of the Authority's draft Annual Report, Annual Governance Statement and Council papers and minutes; and
 - Consideration of the Council's financial results.
-

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit.

Our report includes:

- Our audit plan, including key audit judgements and the planned scope; and
- Key regulatory and corporate governance updates, relevant to you.

Use of this report

This report has been prepared for the Audit and Standards Committee on behalf of the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

We welcome the opportunity to discuss our report with you and receive your feedback.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

We will update you if there are any significant changes to the audit plan.

Deloitte LLP

St Albans, March 2019

Appendices

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Fraud responsibilities and representations

Responsibilities explained



Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.



Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of fraud in completeness of expenditure, and management override of controls as a key audit risk for your organisation.



Fraud Characteristics:

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Council:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:



Management:

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.
- We plan to involve management from outside the finance function in our inquiries.

Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

Those charged with governance

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.



Fees and Independence

As part of our obligations under International Standards on Auditing (UK), and the Companies Act, we are required to report to you on the matters listed below:

| | |
|----------------------------------|--|
| Independence confirmation | We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of Lewes District Council and will reconfirm our independence and objectivity to the Audit and Standards Committee for the year ending 31 March 2019 in our final report to the Audit and Standards Committee. |
| Fees | Details of the fees proposed for the period have been presented below. |
| Non-audit services | We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary. |
| Relationships | As part of our obligations under International Standards on Auditing (UK) and the APB's Ethical Standards we are required to report to you on all relationships (including the provision of non-audit services) between us and the audited entity. |

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The professional fees expected to be charged by Deloitte LLP in the period from 1 April 2018 to 31 March 2019 are as follows:

| | Current year £ (excluding VAT) |
|--|-----------------------------------|
| Financial statement audit including Whole of Government Accounts and procedures in respect of Value for Money assessment | 35,742 |
| Total audit | 35,742 |
| Total fees | 35,742 |

We will communicate our fees in relation to Housing Benefits work (which is separate from the main statement of accounts audit) closer to the work which is scheduled to commence in August.

We confirm all Deloitte network firms are independent of the Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Our approach to quality

AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

All the AQR public reports are available on its website. <https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

The AQR's 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

The firm has enhanced its policies and procedures in the following areas:

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

Our key findings in the current year requiring action by the firm:

- Improve the group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.

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