Commercial in confidence

Grant Thornton

# External Audit Plan Addendum

*Year ending 31 March 2020*

**London Borough of Croydon**

November 2020

# Introduction & headlines

### Purpose

This document provides an update to the planned scope and timing of the statutory audit of the London Borough of Croydon (the Council) as reported in our Audit Plan dated 9 March 2020, for those charged with governance.

### The current environment

In addition to the audit risks communicated to those charged with governance in our Audit Plan on 9th March 2020, recent events have led us to update our planning risk assessment and reconsider our audit and value for money (VfM) approach to reflect the unprecedented global response to the Covid-19 pandemic, the matters raised in the Report In the Public Interest and the section 114 notice issued. The significance of the situation cannot be underestimated and the implications for individuals, organisations and communities remains highly uncertain. For our public sector audited bodies, we appreciate the significant responsibility and burden your staff have to ensure vital public services are provided. As far we can, our aim is to work with you in these challenging times, ensuring up to date communication and flexibility where possible in our audit procedures.

### Impact on our audit and VfM work

Management and those charged with governance are still required to prepare financial statements in accordance with the relevant accounting standards and the Code of Audit Practice, albeit to an extended deadline for the preparation of the financial statements up to 31 August 2020 and the date for audited financial statements to 30 November 2020. Given the wider challenges which the Council has faced during the course of the year, the draft financial statements were received on 16 October 2020 and our audit commenced on 26 October 2020. We expect the audit will continue beyond the end of November but we will look to finish our work is as timely a manner as possible. We continue to be responsible for forming and expressing an opinion on the Council and group's financial statements and VfM arrangements.

In order to fulfil our responsibilities under International Auditing Standards (ISA's (UK)) we have revisited our planning and risk assessment. We may also need to consider implementing changes to the procedures we had planned and reported in our Audit Plan to reflect current restrictions to working practices, such as the application of technology to allow remote working. Additionally, it has been confirmed since our Audit Plan was issued that the implementation of IFRS 16 has been delayed for the public sector until 2020/21.

### Changes to our audit approach

To date we have:

- Identified a number of new significant risks, as described on pages 3 to 6 of this addendum.
- Reviewed the materiality levels we determined for the audit and have identified changes to our materiality assessment. This comes as a result of the further risks identified from revisiting our planning and risk assessment, along with the impact of Covid-19. Details of our reassessment of materiality can be found on page 8 of this audit plan addendum.

### Changes to our VfM approach

We have updated our VfM risk assessment to document our understanding of your arrangements to ensure critical business continuity in the current environment. We have not identified any new VfM risks in relation to Covid-19, however as a result of Public Interest Report we have identified an additional significant risk relating to the governance issues identified in the Report, which is described on Page 7 of this Addendum.

### Conclusion

We will ensure any further changes in our audit and VfM approach and procedures are communicated with management and reported in our Audit Findings Report. We wish to thank management for their timely collaboration in this difficult time.

# Significant risks identified – Accounts - Covid-19 Pandemic

| Risk | Risk relates to | Reason for risk identification | Key aspects of our proposed response to the risk |
|---|---|---|---|
| **Covid-19** | Group and Council | The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expect current circumstances will have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to;<br>• Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation<br>• Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management estimates<br>• Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and<br>• Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties.<br>We therefore identified the global outbreak of the Covid-19 virus as a significant risk, which was one of the most significant assessed risks of material misstatement. | We will:<br>• Work with management to understand the implications the response to the Covid-19 pandemic has on the organisation's ability to prepare the financial statements and update financial forecasts and assess the implications on our audit approach<br>• Liaise with other audit suppliers, regulators and government departments to co-ordinate practical cross sector responses to issues as and when they arise<br>• Evaluate the adequacy of the disclosures in the financial statements in light of the Covid-19 pandemic.<br>• Evaluate whether sufficient audit evidence using alternative approaches can be obtained for the purposes of our audit whilst working remotely<br>• Evaluate whether sufficient audit evidence can be obtained to corroborate significant management estimates such as asset valuations and recovery of receivable balances<br>• Evaluate management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment<br>• Discuss with management any potential implications for our audit report if we have been unable to obtain sufficient audit evidence. |

# Significant risks identified – Accounts – Revenue

| Risk | Risk relates to | Reason for risk identification | Key aspects of our proposed response to the risk |
|---|---|---|---|
| **The revenue cycle includes fraudulent transactions**<br>**Income from fees and charges and other service income** | Group and Council | Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue, which we initially rebutted for both the Group and the Council Audits.<br>However for both audits, we have now concluded that we are unable to rebut that risk for all revenue streams, due to the pressure on the overall financial position of the Group and Council. Our new assessment is that the greatest risk of material misstatement relates to fees and charges and other service income. This income stream is regarded as a material risk as there is increased judgement from management regarding recognition of revenue from fees and charges and other service income compared to income streams such as council tax and NNDR, HRA rental revenues and government grants and contributions.<br>We have therefore identified the occurrence and accuracy of fees and charges and other service income as a significant risk, which was one of the most significant assessed risks of material misstatement and a key audit matter.<br>We have still rebutted this presumed risk for the other revenue streams of the Group and Council because:<br>• Other income streams are primarily derived from grants or formula based income from central government and tax payers; and<br>• opportunities to manipulate revenue recognition are very limited. | We will:<br>• evaluate the Group and Council's accounting policy for recognition of income from fees and charges and other services for appropriateness;<br>• gain an understanding of the Group and Council's system for accounting for income from fees and charges and other services and evaluate the design of the associated controls;<br>• agree, on a sample basis amounts recognised as income from fees and charges and other services in the financial statements to appropriate and sufficient audit evidence to gain assurance over the occurrence and accuracy of income. |

# Significant risks identified – Accounts - Operating Expenditure

| Risk | Risk relates to | Reason for risk identification | Key aspects of our proposed response to the risk |
|---|---|---|---|
| **The expenditure cycle includes fraudulent transactions**<br>**Completeness of operating expenditure and associated creditor balances** | Group and Council | Practice Note 10 suggests that the risk of material misstatement due to fraudulent financial reporting that may arise from the manipulation of expenditure recognition, needs to be considered as a potential significant risk, especially where organisations are required to meet financial targets.<br>Due to the pressure to deliver a balanced budget, the low level of general fund reserves held by the Council and in year budget overspends there is a risk over the completeness of your operating expenditure and associated creditor balances.<br>We have therefore identified the completeness of operating expenditure and associated creditor balances as a significant risk, which was one of the most significant assessed risks of material misstatement and a key audit matter. | We will:<br>• Evaluate the design and implementation effectiveness of the accounts payable system.<br>• Verify that the operating expenses included within the financial statements are complete via review of the reconciliations between the Accounts Payable system and the General Ledger.<br>• Search for unrecorded liabilities by performing a substantive sample of invoices input on to the accounts payable system post period end.<br>• Search for unrecorded liabilities by reviewing cash payments post period end.<br>• Perform substantive testing on a sample of expenditure included within the year to make sure it is correctly recorded<br>• Perform substantive sample testing of liabilities recorded in the ledger to gain assurance that liabilities are accurate and not understated.<br>• We will also performing testing on the expenditure which has been classified as Transformational Expenditure in year to confirm it meets the requirements to be classified in this way. |

# Significant risks identified – Accounts - ETA Schemes

| Risk | Risk relates to | Reason for risk identification | Key aspects of our proposed response to the risk |
|---|---|---|---|
| **Accounting for transactions relating to the Emergency Temporary Accommodation (ETA) Schemes** | Group and Council | In previous years we have considered the Council's Emergency Temporary Accommodation (ETA) Schemes, focusing on both how these schemes have been financed by the Council, along with how they have been accounted for within the Council's Accounts. ETA Tranche1 was reviewed in 2017/18, and an issue was identified relating to the charging of a Reverse Lease Premium, which has been reported in our previous Audit Findings Reports.<br><br>Since then we know that further tranches of the ETA Schemes have come on line with potentially different sources of finance completing in 2019/20. We also have noted a detailed review has been performed on the arrangements by pwc, who have flagged a number of areas for the Council to revisit as part of a wider review in this area. We will undertake further work on the back of the recommendations made by pwc to ensure items are accounted for correctly.<br><br>We therefore identified the accounting for the ETA Schemes as a significant risk, which was one of the most significant assessed risks of material misstatement. | We will:<br>• Evaluate the design and implementation of the Council's processes and controls in this area;<br>• Review the recommendations raised by the pwc report where these impact the balances included within the financial statements and challenge management on the appropriateness of these judgements.<br>• Review the accounting for these schemes within the 2019/20 Accounts, and consider the involvement of technical specialists to gain assurance over the appropriateness of the accounting.<br>• Test the transactions recorded in the 2019/20 financial statements to confirm compliance with the CIPFA Code of Practice for Local Authority Accounting. |

# Significant risks identified – VfM – Governance Issues

| Risk | Risk relates to | Reason for risk identification | Key aspects of our proposed response to the risk |
|---|---|---|---|
| **Governance of Finance and Group Structures** | Council | There is a risk that intended benefits will not be achieved if governance arrangements to make informed decisions do not operate as designed. During our work on the Public Interest Report, we identified several areas where governance arrangements had not been operating as intended.<br><br>As a result we have identified a significant risk for the 2019/20 Value for Money Conclusion where we will assess the impact of identified recommendations on your governance arrangements. | We will:<br>• Consider the findings of a number of reports and the extent to which their recommendations reflect the arrangements operating in 2019/20. The reports we will consider will include<br>  • Report in the Public Interest<br>  • Head of Internal Audit Opinion<br>  • Financial Consultant's review of financial management arrangements<br>  • Pwc review of governance of group structures. |

# 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.

### Revision of Materiality

We have reconsidered our materiality levels as a result of the additional risks identified from a revisit of planning and risk assessment work and subsequent events arising from the Covid-19 pandemic. This has led to changes to the levels which we initially communicated to you in the Audit Plan in March 2020.

We have determined financial statement materiality based on a proportion of the gross expenditure of the Authority for the financial year. In the prior year we used the same benchmark, and this benchmark remains unchanged, but we have reduced the level of this benchmark applied to your audit to reflect the scrutiny on you as a Council. Materiality for the financial statement audit has been revised to £15 million (from £18.5 million) for the Group and £14 million (from £18 million) for the Council, which equates to approximately now 1.2% (was 1.4%) of your current year gross expenditure. The reduction in materiality compared to the previous year reflects the higher profile of local audit following external reviews such as those led by Sir John Kingman and Sir Tony Redmond. We design our procedures to detect errors in specific accounts at a lower level of precision, which we have determined to be £100,000 for the disclosures relating to Senior Officer Remuneration.

We reconsider financial statement 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 General Purposes and Audit 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 General Purposes and Audit 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 both the group and the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £700k (previously £900k) for the Group and the Council.

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