

Audit Progress Report

Gateshead Council

July 2020





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1. SUMMARY

Purpose of this report

This report provides the Audit and Standards Committee with an update on progress in delivering our responsibilities as your external auditor.

Financial Statements Audits

The changes to working arrangements during the COVID-19 'lock-down' period and other pressures in the local government sector has lead to a number of changes to the audit approaches and matters outlined in the Audit Strategy Memorandum.

- Remote working - Mazars moved to working remotely on 16 March 2020. So far these arrangements have worked reasonably well at our clients and the systems in place for sharing information between clients and ourselves have operated as expected. We expect to need to continue to operate on this remote basis throughout the upcoming audits and for the near future, including the reporting and closure stages of the audit. We will continue to work with management to deal with any practical difficulties in delivering the audit as the work progresses.
- Timetable changes – there have been significant changes to the statutory timetable for the 2019/20 accounts preparation and publication. The statutory deadlines for the publication of the draft and audited financial statements have been changed to 31 August (from 31 May) and 30 November (from 31 July) respectively. We have agreed with management changes to the scheduling of our work to accommodate the new timetable. The audit work will now take place in the period July to September based on the draft financial Statements produced on 7 July. We plan to submit our Audit Completion Reports to the Audit and Standards Committee and then the Accounts Committee for approval before we issue the Auditor's Report in early October. This timetable is dependent on a number of factors and we will update to Audit Committee if any changes are required.
- Financial Reporting Issues – a number of key financial reporting issues as a result of the COVID-19 pandemic have emerged over recent weeks. CIPFA's Bulletin 05 on the Closure of the 2019/20 Financial Statements summarises the key points to consider and we have included a summary of the Bulletin at Appendix 2 to this report. We have discussed with management the local position on these issues and other COVID-19 related matters and are taking them into account in our detailed audit work.

We have included at Section 2 of this report a summary of the current position on the audit risks and other reporting requirements set out in our 2019/20 Audit Strategy Memorandum. We will report further on these matters in our Audit Completion Report in October 2020. We have also included an updated Communications and Timeline summary at Appendix 1.

2. AUDIT PROGRESS

This section includes a revisit of the significant risks and key judgement areas in the 2019/20 Audit Strategy Memorandum , updated where appropriate. Due to Covid-19 we have carried out a review of these risks and have updated where relevant. We have also identified an additional significant risk along with an enhanced risk. We will report the final position on this matters in our Audit Completion Report.

	Description of risk	Planned response
1	<p>Significant risk</p> <p>Management override of controls</p> <p>Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	We plan to address the management override of controls risk through performing audit work over accounting estimates, journal entries and significant transactions outside the normal course of business or otherwise unusual.
2	<p>Significant risk</p> <p>Revenue recognition (relevant to the Council)</p> <p>Our audit methodology incorporates this risk as a significant risk at all audits, although based on the circumstances of each audit, it is rebuttable. We have concluded that we can rebut the presumption of a revenue recognition risk for the majority of the Council's revenue streams, consisting largely of taxation, business rates and grant income.</p> <p>However, we do not feel that sufficient scope exists to rebut this risk in respect of the recognition of fees, charges and other income given the demand led nature of these revenue streams . This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.</p>	<p>We will address this risk by completing a range of substantive procedures including:</p> <ul style="list-style-type: none"> • substantively testing fees, charges and other income to ensure it has been correctly classified and recognised; • testing journals; and • obtaining direct confirmation of year-end bank balances and test the reconciliations to the ledger.

2. AUDIT PROGRESS (CONT.)

	Description of risk	Planned response
3	<p>Significant risk</p> <p>Defined benefit liability valuation</p> <p>The financial statements contain material pension entries in respect of retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.</p> <p>The risk has increased as a result of the economic downturn arising from COVID-19.</p>	We will discuss with key contacts any significant changes to the pension estimates. In addition to our standard programme of work in this area, we will evaluate the management controls you have in place to assess the reasonableness of the figures provided by the Actuary and consider the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is carried out annually by the NAO's consulting actuary (PwC).
4	<p>Significant risk</p> <p>Property, plant and equipment – valuation (relevant to the Council)</p> <p>The financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Council's holding of PPE.</p> <p>Although the Council employs external valuation experts to provide information on valuations, there remains a high degree of estimation uncertainty associated with the revaluation of PPE due to the significant judgements and number of variables involved in providing revaluations. We have therefore identified the revaluation of PPE to be an area of risk.</p> <p>The risk has increased as a result of the economic downturn arising from COVID-19.</p> <p>We note also the Valuation Practice Alert issued by the valuation body The Royal Institute of Chartered Surveyors (RICS) recently. This highlighted the use by Valuers, where appropriate, of material uncertainty declarations in their valuation reports.</p>	<p>We plan to address this risk by completing the following procedures:</p> <ul style="list-style-type: none"> • consider the Council's arrangements for ensuring that PPE values are reasonable; • use an external expert (Gerald Eve) to provide data to enable us to assess the reasonableness of the valuations provided by the Council's valuers; • assess the competence, skills and experience of the valuers; and • where necessary we will also perform further audit procedures on individual assets to ensure that the basis and level of revaluation is appropriate.

2. AUDIT PROGRESS (CONT.)

	Description of risk	Planned response
5	<p>Significant risk</p> <p>Valuation of short and long-term debtors</p> <p>There is an increased risk that the valuation of debtors, both short and long-term, will be impacted by the economic downturn.</p> <p>The Council's long-term debtors includes loans to other bodies and Newcastle Airport.</p> <p>The Council also has provided for the potential impairment of short-term debtors which may be impacted by the economic downturn.</p>	<p>We will:</p> <ul style="list-style-type: none"> • critically review the basis of valuation of short and long-term debtors; • challenge the assumptions made by the Council; and • seek specific representations from management.
6	<p>Enhanced risk</p> <p>Valuation of long-term investments (Airport shares and other investments)</p> <p>The Council has to make judgements in respect of the fair value measurements of unquoted equity investments it holds, namely Newcastle Airport.</p> <p>The risk has increased as a result of the economic downturn arising from COVID-19.</p>	<p>We will:</p> <ul style="list-style-type: none"> • assess the basis of valuation for the Council's shares in the Airport; • critically review the assumptions made by management; and • assess whether disclosures are in line with the Code of Audit Practice.

2. AUDIT PROGRESS (CONT.)

Value for Money Conclusion

In our Audit Strategy Memorandum we reported that we had identified one significant risk to our 2019/20 VFM conclusion, outlined below

Description of significant risk	Planned response
<p>Sustainable resource deployment</p> <p>Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions</p> <p>The Council continues to face financial pressures from reduced funding, increased demand and changing responsibilities. The Council is responding to the challenges with a programme of efficiencies, service reviews and developing new ways to manage demand and deliver services. Failure to have appropriate arrangements in place to identify and deliver this programme poses a significant risk to the Council's ability to deliver its strategic priorities and maintain statutory functions.</p>	<p>We will review:</p> <ul style="list-style-type: none">• monitoring and action plans for a sample of savings included in the budget;• the updated Medium-Term Financial Strategy;• budget monitoring reports and other finance updates; and• the progress made in identifying further savings required;

We keep our assessment up to date and before concluding on the work take into account any matters which come to our attention through the course of our audit which may affect our reporting. Our Audit Strategy Memorandum sets out the sources of information we consider. We have not to date identified any matters in those areas which indicate any additional significant VFM risks or that we will be unable to give an unqualified VFM conclusion. NAO's updated guidance clarifies that auditors should generally consider local bodies' arrangements and their response to the COVID-19 pandemic as part of their 2020/21 work on VFM arrangements. Only where there is a clear indication of a significant failure of arrangements during the 2019/20 as a result of COVID-19 would it be appropriate to raise a 2019/20 significant VFM risk. We have not identified any significant failures in the Council's arrangements during 2019/20 and are satisfied that no additional significant VFM risks have been identified.

2. AUDIT PROGRESS (CONT.)

Materiality

Our Audit Strategy Memorandum set out our planning materiality assessments for 2019/20, based on the audited 2018/19 financial statements. We will update these assessments on receipt of the 2019/20 draft statements and will report the updated materiality levels and any audit differences in our Audit Completion Report.

Other Reporting Matters

We have no issues to report at this stage in relation to the following audit matters:

- Fraud
- Significant internal control deficiencies
- Accounting practices
- Non-compliance with laws and regulations
- Practical difficulties in carrying out the audit or co-operation from management
- Threats to our independence

APPENDIX 1 – COMMUNICATIONS AND TIMELINE

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specify the matters we are required to communicate to you. These matters, and the reports we will issue, are as follows:

Required communication	Audit Strategy Memorandum Reported to Audit and Standards committee in March 2020.	Audit Completion Report To be presented to Audit and Standards committee and Accounts committee in October 2020
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Our commitment to independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality and misstatements	✓	✓
Fees for audit and other services	✓	
Significant deficiencies in internal control		✓
Significant findings from the audit		✓
Significant matters discussed with management		✓
Our conclusions on the significant audit risks and areas of management judgement		✓
Summary of misstatements		✓
Management representation letter		✓
Our proposed draft audit report		✓

APPENDIX 2 – CIPFA YEAR END BULLETIN

CIPFA's Bulletin 05 on the Closure of the 2019/20 Financial Statements (May 2020) summarises the key points for local authorities to consider and includes a particular focus on areas impacted by the COVID-19 pandemic. A copy of the Bulletin can be found via the following link:

<https://www.cipfa.org/policy-and-guidance/cipfa-bulletins/cipfa-bulletin-05-closure-of-the-201920-financial-statements>

We have included below a summary of the matters highlighted in the Bulletin and their impact on our audit approach.

Topic	Description	Comment
Dedicated Schools Grant	The Bulletin confirms the expected accounting and disclosure of deficit and surplus balances carried forward in the 2019/20 accounts.	We have discussed the topic with management and the Council is expected to prepare its draft financial statements following the CIPFA guidance.
Accounting for McCloud and Sargent Judgements in 2019/20	The Bulletin provides updated guidance on the recognition and accounting for these liabilities.	We have discussed the topic with management and the Council is expected to prepare its draft financial statements following the CIPFA guidance.
Changes to the 2019/20 financial reporting deadlines	The Bulletin confirms the changes to the 2019/20 timetable	The accounts timetable and our planned audit dates have been changed to reflect the new dates.
Deferral of the implementation of IFRS16	The implementation of IFRS 16 Leases has been deferred for one year in-line with the government's Financial Reporting Advisory Board's proposals for central government departments. The effective date for implementation is now 1 April 2021.	Management is aware of this deferral.
Going concern basis of accounting	The Bulletin confirms that despite the impact of COVID-19 on local authority financial sustainability the going concern basis of reporting in the Code and the rationale behind it remains unchanged. The Bulletin does though highlight the need for local authorities to report on the impact of financial pressures in the narrative report will also need to ensure that their reports on credit risks in the financial statements appropriately reflect the impact of the COVID-19 pandemic.	We have discussed this with management and the matters highlighted in the Bulletin are being considered as part of the preparation of the draft 2019/20 financial statements.
Accounting for COVID-19 support measures	The Bulletin clarifies the role of councils as 'agents' or 'principles' in the distribution of grants and the expected accounting treatment.	Management is aware of the guidance and the reporting requirements.
S.31 Grants for 2020/21 paid in 2019/20	The Bulletin sets out the issues to consider in recognising this income in the 2019/20 financial statements.	Management is aware of the guidance and expected to prepare its draft financial statements following the CIPFA guidance.

APPENDIX 2 – CIPFA YEAR END BULLETIN (CONT.)

Topic	Description	Comment
Financial reporting issues arising from COVID-19	<p>The issues highlighted include:</p> <ul style="list-style-type: none"> • The assessment and disclosure of relevant events after the reporting period • Impact on land and buildings valuations • Fair values of investments and investment properties • Expected Credit Losses • Narrative Reporting • Reporting significant accounting judgements and estimation uncertainty. 	<p>We have discussed these matters with management and the issues highlighted in the Bulletin are being considered as part of the preparation of the draft 2019/20 financial statements. The matters relating to land and buildings valuation overlaps with a significant audit risk identified in our Audit Strategy Memorandum and will therefore be a specific area of focus for our audit work and reporting.</p>
Impact of COVID-19 on Pension Fund investment measurement and Impairment	<p>The Bulletin highlights a number of significant matters relating to the impact of COVID-19 on year end values and the increased estimation uncertainty. The Bulletin identifies the importance of pension funds engaging early with its fund managers, custodians and investment advisers to ensure it is well placed to prepare materially accurate financial statements and make disclosures (regarding, for example, estimation uncertainty) which are complete and up to date.</p>	<p>We have discussed these matters with management and the issues highlighted in the Bulletin are being considered as part of the preparation of the draft 2019/20 financial statements. This overlaps with a significant audit risk identified in our Audit Strategy Memorandum and will therefore be a specific area of focus for our audit work and reporting.</p>

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