Horsham District Council

Audit Committee Progress Report

March 2020

Building a better working world

Contents

1. 2019/20 Audit

Auditing planning update

Since our last report, we have completed our planning for the 2019/20 financial statements audit, and our value for money risk assessment. We have identified one additional significant risk and one further area of audit focus since our Audit Planning Report was presented in December 2019.

Additional Significant Risk: Valuation of retail property	
How has this risk arisen?	**How will we address this risk?**
The Council holds a significant investment in retail property. The valuation of property is complex and subject to several assumptions and judgements. A small movement in these assumptions can have a material impact on the financial statements. Difficulties in the retails sector have led to many retailers, including well-known names, closing stores, going into administration, or otherwise looking to reduce their rental costs by renegotiating existing leases. These difficulties have had a direct impact on the value of the retail units (high street shops, out of town retail parks and shopping centres) leased to retailers	As we have now identified the risk as significant we will instruct our own Property valuation team (EY Real Estates) to review a sample of retail property valuations performed by the Councils Valuer. Our valuer will; • consider the competence, capability, and objectivity of the Council's valuers; • sample test key inputs used by the valuer(s) when producing valuations • challenge the assumptions used by the Council's valuers by reference to external evidence

Additional Area of Audit focus: Restatement on the Comprehensive Income and Expenditure Statement (CIES), Expenditure and Funding Analysis (EFA) and related disclosure notes	
How has this risk arisen?	**How will we address this risk?**
Under CIPFA's "Telling the Story" agenda, the Council is required to disclose its income and expenditure in accordance with the structure used for internal reporting, rather than the previous presentation as prescribed by SERCOP. The Council has changed its internal reporting structure in 2019/20, which will mean the Comprehensive Income and Expenditure Statement, the supporting Expenditure and Funding Analysis, and related disclosure notes, will need to be restated in line with the new structure.	• Agree the restated comparative figures back to the Council's prior year financial statements and supporting working paper • Review the analysis of how these figures are derived from the Council's ledger system and how overheads are apportioned across the service areas reported

These additional areas of work will result in a variation to the scale fee.

Interim visit progress

We are currently undertaking our interim visit in March 2020 and have made considerable progress in several areas. Notably we have progressed work in the following areas:

- Income and expenditure – we have sample tested months 1-9 of the Council's income and expenditure
- Payroll – we ran our payroll analytics programme over the month 1-9 data, this showed the posting pattern was in line with our expectations
- Additions and disposal – we sample tested key additions and disposal at year to date of our audit visit
- Property valuations – we are currently performing a detailed review of the key estimates the Council's intends to post in the 2019/20 financial statements
- IFRS 16 – we are currently reviewing the Council's impact assessment of IFRS 16 which is applicable for 2020/21 financial year.

We have not identified any issues which require your attention.

Calculation of our Planning Materiality in context of the public sector

Measurement basis

The measurement basis for determining materiality is a matter of professional judgment. The measurement base we believe to be most important to the users of the financial statements affects our decision. In the case of a public sector entity, the Financial Reporting Council *recommended practice – Practice note 10: audit of financial statements of public sector bodies in the United Kingdom* (PN10) states that legislators and regulators are often the primary users of its financial statements. Therefore, we consider these groups use of the financial statements when selecting our measurement basis for materiality.

We broadly categorise the measurement bases into three categories

- Earnings-based measures include pre-tax income; earnings before interest, taxes, depreciation, and amortization (EBITDA); and gross margin
- Activity-based measures include revenues and operating expenses
- Capital-based measures include equity and assets

The Financial Report Council's PN10 states the following:

'Gross expenditure or gross assets/liabilities may be more appropriate than profit or revenue as benchmarks for setting materiality for financial statements as a whole'

Our Global methodology sets out that gross expenditure, which is defined as all expenditure the Council incurs including Housing benefits, is the appropriate measurement basis for our Public Sector audits and is therefore used consistently across our Local Government audits. Annually, our Professional Practice Directorate (PPD) review this approach compared with other firms involved in the audit of Local Government. This review shows gross expenditure is used as the measurement basis for materiality consistently across the sector.

Determine the appropriate Percentage to apply to the measurement basis

Our methodology allows us to apply either a 0.5%, 1%, or 2% to the measurement basis to calculate our materiality. In determining which of the relevant percentage to apply, we consider both quantitative and qualitative aspects of the financial statements and have regard to items such as:

- The prior year's Audit opinion (Disclaimed, Qualified)
- The entities recent, current and medium-term financial sustainability
- The entities planned or actual proximity to any Financial Statements based performance metric
- Any unusual or contentious, planned or actual commercial activities
- Any relevant qualification of the Value for Money conclusion in the prior years
- Viability of the business, including level of available revenue reserves
- History of achieving financial performance against targets
- Positive outcomes from recent regulatory and other inspectorates' reviews
- Stable Business Environment, including no plans to restructure related Government or public sector functions
- Low public profile of the entity
- Minimal external financing (excluding PWLB), without unusual financing characteristics given the type of entity considerer

Having assessed the above factors for Horsham District Council our professional judgement is 2% is the right percentage to apply to the measurement basis, which is consistent with our

judgement from all of the recent external audits undertaken by EY for HDC. We do not believe that there are any significant change in any of the factors that would change our judgement. Clearly if there were any, and our judgement was that the percentage would need to be lower, it would significantly increase the audit procedures required, and impact on both the timing and cost of the external audit.

Performance materiality

Performance materiality is used to apply our overall planning materiality to individual balances and disclosures in the financial statements.

We set performance materiality to reduce the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality to an appropriately low level. We also use performance materiality as an estimate of undetected misstatements within the financial statements when we conclude on uncorrected misstatements.

Elements of our audit approach impacted by the determination of performance materiality include:

- Accounts we identify as significant
- Our sample sizes

We form an expectation as to the likelihood and size of misstatements when setting performance materiality. This judgment is informed by the scale and nature of errors found in the prior period, the entity's control environment, and any significant changes in circumstances in the current year.

When we can assess, with sufficient confidence, that detected misstatements will not exceed 25% of planning materiality, we may consider the likelihood of misstatements to be lower. When we are not able to do so, we consider the likelihood of misstatements to be higher. In the former circumstance, we are likely to set performance materiality at 75% of planning materiality. Where the expectation of errors is higher, we are likely to set performance materiality at 50% of planning materiality. Where prior year errors were concentrated in one area, rather than being pervasive to the accounts, we may consider setting overall performance materiality at 75% but using lower testing thresholds for the balances impacted by errors in the prior year, to ensure our work is sufficiently focused on areas of risk in the current year.

For Horsham District Council, performance materiality has been set at 75% for 2019-20. As noted in our Audit Plan (as updated by this progress report), lower testing thresholds will be applied in our testing of capital additions, Pensions and Property Valuations in recognition of risk identified in those areas of the accounts.

Trivial level

In addition to determining planning materiality and performance materiality, we determine an amount below which identified misstatements are considered clearly trivial. We would not normally require errors below this value to be corrected or report them to those charged with governance. However, we do generally report all errors identified to management, who will decide whether to correct these.

This measure is determined by EY policy and is set at 5% of planning materiality for all clients.