

READING BOROUGH COUNCIL
REPORT BY HEAD OF FINANCE

TO:	AUDIT & GOVERNANCE COMMITTEE		
DATE:	28 JANUARY 2016	AGENDA ITEM:	3
TITLE:	INTRODUCTION OF EY LLP, APPOINTED EXTERNAL AUDITOR FROM 2015/16		
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1. PURPOSE AND SUMMARY OF REPORT

- 1.1 This report introduces then new external auditor to the Audit and Governance Committee. EY LLP will be attending the meeting to provide a general briefing to Members and their audit plan for 2015/16 on their approach to the audit given their perception of the risk environment, their timetable and the anticipated outputs from it.

2. RECOMMENDATION

- 2.1 To note the content of the report.
- 2.2 To consider and note the briefing and external audit plan 2015/16 of EY LLP, which will be presented by their Executive Director Paul King and engagement Senior Manager Alan Witty.

3. POLICY CONTEXT

- 3.1 Prior to the demise of the Audit Commission, that body changed the external audit appointment to the Council from KPMG LLP to EY LLP for from the financial year 2015/16 for a period of 2 years. The DCLG has since extended that contract by a further year.
- 3.2 The Audit Commission closed on 31 March 2015. Public Sector Appointments Ltd (PSAA), an independent company set up by the local Government Association, will

oversee the above contract until it ends in 2017 (or 2020 if it is extended by the Department of Communities and Local Government).

- 3.3 The responsibility for publishing the statutory Code of Audit Practice, under which EY LLP will conduct the audit, rests with the National Audit Office

4. EXTERNAL AUDIT PRESENTATION AND ATTACHMENTS

- 4.1 Local government sector briefing - Attachment 1

- 4.2 External Audit 2015/16 Plan - Attachment 2.

- 4.3 With regard to the risks set out in the audit plan, the Authority has the following comments to make:

Financial Statement Risks - page 3 and 4

Significant Risks

Fraud in revenue and/ or expenditure recognition. Risk of management override. These are fairly generic risks and understandable in particular in the context of where there has been a change in auditor.

Non-Significant Risks

The risk of understatement of unequal pay provision, valuation of Property, Plant and Equipment and Valuation of Investment properties. These largely flow from the KPMG ISA 260 report to the Audit and Governance Committee in September 2015. The *reliance on one contractor to prepare year-end financial information* whilst being a specific issue, is also a general one around the resilience of the accounts production process, given reducing resources within the Authority.

Economy, efficiency and effectiveness - page 6

Significant Risk

Delivering financial resilience. This risk is affecting many local authorities given the very challenging financial settlement, coupled with the demand pressures being faced within service areas.

5. FINANCIAL IMPLICATIONS

- 5.1 EY LLP wrote to the Authority on 27 April 2015 setting out the Annual Audit and Certification Fees. This fee is predicated upon certain assumptions being met and the risk profile not changing significantly since the Audit Commission set the fee. The indicative fee for Code work in 2015/16 is £108,938 and £20,187 for the

certification of the housing benefit subsidy claim. Any significant variance to these indicative fees will need to be agreed with the Committee. Any additional work outside the code of practice will be separately negotiated and agreed in advance.

- 5.2 The scale of audit fees are also published on the PSAA Ltd website (see link below).

<http://www.psa.co.uk/audit-and-certification-fees/201516-work-programme-and-scales-of-fees/individual-fees-for-local-government-bodies/>

- 5.3 The scale of the audit fees for 2016/17 is currently being consulted upon.

6. LEGAL IMPLICATIONS

- 6.1 These arrangements are governed by the Local Audit and Accountability Act 2014.

7. CONTRIBUTION TO STRATEGIC AIMS / COMMUNITY ENGAGEMENT /EQUALITY IMPACT ASSESSMENT

- 7.1 None directly from the report.

8. BACKGROUND PAPERS

- 8.1 Various documents from EY LLP, NAO the Audit Commission and PSAA Ltd have been referred to.

Local government audit committee briefing

Contents at a glance

Government and economic news

Accounting, auditing and governance

Regulation news

Key questions for the audit committee

Find out more

This sector briefing is one of the ways that we hope to continue to support you and your organisation in an environment that is constantly changing and evolving.

It covers issues which may have an impact on your organisation, the Local government sector and the audits that we undertake.

The public sector audit specialists who transferred from the Audit Commission form part of EY's national Government and Public Sector (GPS) team. Their extensive public sector knowledge is now supported by the rich resource of wider expertise across EY's UK and international

business. This briefing reflects this, bringing together not only technical issues relevant to the local government sector but wider matters of potential interest to you and your organisation.

Links to where you can find out more on any of the articles featured can be found at the end of the briefing, as well as some examples of areas where EY can provide support to Local Authority bodies.

We hope that you find the briefing informative and should this raise any issues that you would like to discuss further please do contact your local audit team.



Government and economic news

EY Item Club Autumn Forecast

The latest EY Item Club forecast (Autumn 2015) predicts tougher times for the UK economy as what it describes as the 'consumer sugar rush' begins to fade.

GDP is forecast to grow by 2.5% this year (compared to 2.9% in 2014) and slow further to 2.4% in 2016 and 2.3% the year after. Consumer Price Inflation is expected to remain below target until 2018. Prospects for exports remain poor, and domestic consumption is likely to be affected by rising inflation and tighter fiscal policy from early 2016. Progress is seen to depend upon productivity gains rather than coming from the commodity price falls that are supporting demand this year. Businesses will need to work hard on overseas markets as opposed to relying on consumer-led domestic markets.

The forecast highlights that the last decade has seen a strong increase in the supply of labour which has depressed real wages and, arguably, productivity, but that we are now seeing a more normal recovery. This is characterised by an increase in the demand for labour, which boosts real wages and productivity. Wage inflation is highlighted as being strong. This is expected to be boosted further in April 2016 by the National Living Wage, the effects of which could be very significant for some sectors and regions.

Provided that increased productivity matches wage inflation, the expectation is that the Monetary Policy Committee will keep base rates on hold until next autumn.

For details of the EY Item Club's latest forecast, see <http://www.ey.com/UK/en/Issues/Business-environment/Financial-markets-and-economy/ITEM---Forecast-headlines-and-projections>

Housing Associations Right to Buy

The Chartered Institute of Public Financial Accountants (CIPFA) has produced a briefing following the Government's announcement in October that it intends to extend its Right to Buy scheme to Housing Associations. The briefing seeks to explore the potential impact of these plans on Local Authorities.

Local authority housing is intended to be self-financing, based on 30 year business plans established in 2012 with the HRA self-financing regime, with Council housing for each council financed from its own rental income. This principle was reflected in the 30 year business plans, but CIPFA suggests that these business plans do not reflect recent changes contained within the budget. These changes include amendments to the rent policies as well as the proposed sale of high value local authority housing stock in order to compensate housing associations for the shortfall in income caused by the new Right to Buy scheme.

According to CIPFA, research has shown properties sold under the existing Right to Buy scheme have in many instances returned to the rental market at a higher level of rent than council levels. They have cited the example of Barking and Dagenham where it is said that 41% of properties purchased under the Right to Buy scheme are now let privately.

CIPFA warns 'Any legislation that leads to a negative impact on the housing business plan models of local authorities could seriously undermine the very basis of self-financing which promised autonomy for local authorities in the delivery of housing in their areas.'



Government and economic news

However, Communities Secretary Greg Clark said:

“We’re determined to ensure that home ownership is seen as a reasonable aspiration for working people.

Right to Buy is a key part of this, offering a helping hand to millions of people who would have no hope of buying their own home without it.

Today’s historic agreement with housing associations and the National Housing Federation will extend that offer even more widely, whilst at the same time delivering thousands of new affordable homes across the country.”

The Government agreement with housing associations and the National Housing Federation will see housing association tenants able to buy their homes from 2016.

CIPFA’s briefing document can be downloaded from <http://www.cipfa.org/cipfa-thinks/briefings>, and further information from the government is available at <https://www.gov.uk/government/news/historic-agreement-will-extend-right-to-buy-to-13-million-more-tenants>

Consultation: improving efficiency on Council Tax Collection

Council tax collection rates have been relatively high in recent years: 97% across England in both 2014/15 and 2013/14. However, the Government is looking at ways to enable local authorities to further improve collection rates.

To this end, the Government has issued a consultation on its proposals to improve the collection and enforcement process for council tax. The government’s stated intention is to help local authorities to keep council tax rates low, and so the proposals are aimed at ensuring that everyone contributes fairly.

The consultation follows a trial by Manchester City Council, Salford City Council, HMRC and the Cabinet office under the ‘Better Business Compliance Cabinet programme’, and reflects consideration of the findings from this trial.

An example of this is the Government’s proposal to extend the data-sharing gateway which currently exists between HMRC and local authorities. This would enable HMRC to share employment information with councils where council tax debtors have not voluntarily shared the information within 14 days of receiving a liability order. Manchester estimates, based on its pilot with HMRC, that this would recover £2.5mn of debt in its area alone.

The consultation also asks for other suggestions to improve council tax collection.

Responses are requested by 18 November 2015.

For more information on the consultation and details on how to respond, please see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/466386/150930_Improving_Efficiency_of_Council_Tax_collection_Consultation_Doc.pdf



Government and economic news

Local Plans for New Homes

In October, the Government announced that councils will be required to produce local plans for new homes by 2017. Where councils fail to do so, the Government will consult with local people to ensure that plans are produced for them.

In 2012, the National Planning Policy Framework was introduced to provide guidance for local planning authorities and decision-takers, both in drawing up plans and making decisions about planning applications. This framework reinforced the role of local plans. It required the plans to include an annual trajectory over a period of around 15 years of how many homes they plan to build in their area, and it required local authorities to review this plan approximately every 5 years. Councils were also encouraged to give local people more say on where new developments would be located and what they would look like.

The Government have said that the response to this has been mixed:

- ▶ 82% of councils have published local plans which state how many homes they intend to build over a given period
- ▶ 65% have fully adopted these plans
- ▶ Nearly 20% of councils do not have an up to date plan

If councils fail to produce and bring into force an up to date plan for new homes by 2017, the Government intends to work with local people to ensure one is created.

Read the government press release at <https://www.gov.uk/government/news/prime-minister-councils-must-deliver-local-plans-for-new-homes-by-2017>



Accounting, auditing and governance

Proposals for further emergency services collaboration announced

The Government has launched a consultation which is looking into how the three core emergency services of Police, Fire and Rescue and the Ambulance service could potentially work together in a more efficient and effective manner. Key features of the consultation include:

- ▶ Enabling Police and Crime Commissioners (PCCs) to take on the duties and responsibilities of Fire and Rescue Authorities where a local case was made for this to happen
- ▶ Where a case is made by a local PCC to take on such a role, there would also be the possibility for them to take on the role of a single employer and in doing so enable the sharing of back office support functions
- ▶ Improving joint working between PCCs and local NHS Ambulance Foundation Trusts by encouraging them to allow PCCs to sit on their Council of Governors

The Government also intends to introduce a new statutory duty for the three emergency services to collaborate with one another; and sees this as not being a burden, but is about seeking efficiencies.

However, a key legal distinction would remain under the new proposals, in that a member of a police force will not be permitted under law to become a firefighter, and firefighters will not be given the power of arrest. In order to maintain transparency for local taxpayers, funding from central government will remain separate for police and fire organisations, as will council tax precepts.

<https://www.gov.uk/government/news/proposals-for-further-emergency-services-collaboration-announced>

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/459986/Consultation_-_Enabling_closer_working_between_the_Emergency_Services__w__2_.pdf

Finance in the Cloud?

Cloud computing allows users to rent access to a variety of virtual computing options, conveniently, ranging from network-accessible data storage and software development environments to fully featured applications. As such, the data and applications are not required to be stored on local servers or 'on-premise'; rather, they are hosted and managed by third-party cloud service providers (CSPs).

Enterprises essentially outsource varying levels of IT functionality to CSPs, and users only need an internet connection to access the data and applications via virtual servers. By moving into the cloud, organisations have the potential to reduce greatly, or even eliminate, the total cost of ownership (TCO) of the IT function, thereby forever altering their business model.

The benefits of cloud adoption are highly touted. However, over a decade ago, on-premise enterprise resource planning (ERP) solutions made similar promises. Although the trigger for rushed ERP implementations in the 1990s was the much-fretted Year 2000 (or Y2K) calamity, Y2K concerns turned out to be largely unfounded, and many finance executives would now argue that they have yet to reap genuine, tangible benefits from investing in costly ERP systems.



Accounting, auditing and governance

Although a company's financial management system is critical to success, EY is finding that many organisations have systems averaging from 10 to 15 years old, with upgrade cycles ranging from 5 to 10 years. Despite aging legacy systems, many finance decision-makers are hazy on how cloud solutions are really any different from the ERP solutions hyped in the previous decade.

Organisations that truly understand cloud technology, as well as the associated challenges and risks, are better placed to manage the impact of cloud computing on the finance function. Moreover, they must engage an agile innovation strategy focused on deploying the right operating model in order to realize fully the benefits of cloud computing.

In EY's experience, organisations that fail to make a robust cloud risk assessment often need to make subsequent, costly changes to the cloud model, thereby negating any savings gained from cloud migration. EY recommends that organisations develop a clear, attainable cloud strategy, including an appropriate operating model accompanied with a cloud risk management approach to mitigate risks and avoid a premature move to the cloud.

EY has a proven framework for cloud models, along with risk assessments and broad-based diagnostics to evaluate and optimise a cloud strategy that enables minimal disruption whilst accelerating an organisation's evolution. For more information on this, please talk to a member of your engagement team or read the EY publication at http://performance.ey.com/wp-content/uploads/downloads/2015/10/EY-Performance-Finance-in-the-cloud_Final.pdf

Value for Money Conclusion guidance

The NAO have recently released a consultation document (<http://www.nao.org.uk/keep-in-touch/wp-content/uploads/sites/11/2015/08/Vfm-arrangements-auditor-guidance-consultation-document.pdf>) a consultation document for auditors on their review of arrangements to secure economy, efficiency and effectiveness in their use of resources. This is also referred to as the three E's or the Value for Money (VfM) conclusion. The guidance covers the VfM work for 2015/16.

Based on the responses received to a similar consultation in 2014 the new draft guidance seeks to:

- ▶ Take forward existing guidance and reflect changing circumstance for public sector organisations such as finding savings and maintain financial stability over the medium and long term
- ▶ Update the definition of 'proper arrangements'
- ▶ Strengthen guidance on the identification and work around significant risks whilst maintaining a risk based approach
- ▶ Update and clarify the range of reporting opinions available to auditors and expectations at key stages of the audit
- ▶ Maintain sector specific guidance that will sit outside of the statutory guidance but can provide up-to-date information on sector specific risks

The consultation closed on 30 September and the NAO will communicate a summary of the responses once they have reviewed them. Further information can be found at <https://www.nao.org.uk/keep-in-touch/our-surveys/consultation-auditors-work-on-value-for-money-arrangements/>.



Regulation news

Consultation on 2016/17 proposed fee scales

Public Sector Audit Appointments (PSAA) is currently consulting on both the work programme and scale of fees for 2016/17 audits. The consultation describes the work that auditors will undertake at principal audited bodies for 2016/17 and their associated scales of fees.

There are no planned changes to the overall work programme for 2016/17 and their proposal is to set scale audit fees at the same level as the scale fees for 2015/16 which already reflect a reduction of 25% in addition to the reduction of up to 40% made from 2012/13.

A change in accounting requirements in 2016/17 relating to highways infrastructure assets will require additional audit work at some authorities. As the amount will differ between authorities, the fee variation process will apply in 2016/17 for this additional work.

The consultation closes on Friday 15th January 2016, and the final work programme will be published following this in March 2016.

For details of the consultation, please refer to the PSAA website at <http://www.psaa.co.uk/audit-and-certification-fees/consultation-on-201617-proposed-fee-scales/>

NAO Case Study: managing reductions in local authority government funding

The National Audit Office (NAO) has made available more than 30 case studies which give examples of how organisations have used their recommendations or analysis to support the achievement of financial savings.

One of these case studies follows the production of its 2014 report 'Financial Sustainability of Local Services'

The NAO case study states that following their report, the Department for Communities and Local Government (DCLG) has acknowledged that its processes for estimating local authority spending requirements and assessment the potential impacts of spending reductions need to be improved.

They also note use of their report in the sector, citing the following examples:

- ▶ Leeds City Council and Birmingham City Council have drawn on the work in their debates with central government over devolution
- ▶ Wolverhampton City Council and Oldham Council have used the work to inform discussion and decision-making in cabinet meetings and audit and scrutiny meetings
- ▶ The Local Government Association and treasurers' societies have used the analysis from the report to inform their thinking

Find out more about the impact made by NAO reports in their interactive pdf at <https://www.nao.org.uk/wp-content/uploads/2015/10/Impacts-case-studies-2014.pdf>



Key questions for the audit committee

What questions should the Audit Committee ask itself?

Have we considered the impact of the extension of Right to Buy and reflected our consideration in our Medium Term financial plans and/or Local Plan?

How successful are we in systematically improving our collection rates for Council Tax? Is there best practice that we could share via the Government's consultation?

What is our mid to long term IT strategy? Are we considering cloud-based IT and if so how robust are our risk assessments supporting the shift?

Have we formulated a response to the PSAA consultation on the work programme and scale of fees for 2016/17?



Find out more

EY Item Club Autumn Forecast

For details of the EY Item Club's latest forecast, see <http://www.ey.com/UK/en/Issues/Business-environment/Financial-markets-and-economy/ITEM---Forecast-headlines-and-projections>

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Reading Borough Council

Year ending 31 March 2016

Audit Plan

28 January 2016

Ernst & Young LLP



Building a better
working world

Members of the Audit and Governance Committee
Reading Borough Council
Civic Offices
Bridge Street
Reading
RG1 2LU

28 January 2016

Dear Committee Members

Audit Plan

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit and Governance Committee with a basis to review our proposed audit approach and scope for the 2015/16 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

2015/16 will be our first year as your external auditor. We are currently working through the transitional arrangements with our predecessors, KPMG, including a review of their files. This report therefore summarises our preliminary assessment of the key issues which drive the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks. We will present you with an update of our audit plan at a subsequent meeting when all transitional arrangements have been completed, and our interim planning work performed.

We welcome the opportunity to discuss this plan with you 28 January 2016 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Paul King
Executive Director
For and behalf of Ernst & Young LLP
Enc

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued “Statement of responsibilities of auditors and audited bodies 2015-16”. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Plan is prepared in the context of the Statement of responsibilities. It is addressed to the Audit Committee, and is prepared for the sole use of the audited body. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

1. Overview

Context for the audit

This Audit Plan covers the work that we plan to perform to provide you with:

- ▶ Our audit opinion on whether the financial statements of Reading Borough Council give a true and fair view of the financial position as at 31 March 2016 and of the income and expenditure for the year then ended;
- ▶ Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness; Our audit opinion on the regularity of expenditure and income; and

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- ▶ Strategic, operational and financial risks relevant to the financial statements;
- ▶ Developments in financial reporting and auditing standards;
- ▶ The quality of systems and processes;
- ▶ Changes in the business and regulatory environment; and
- ▶ Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

We will provide an update to the Audit and Governance Committee on the results of our work in these areas in our report to those charged with governance scheduled for delivery in September 2016.

Our process and strategy

Financial statement audit

We consider materiality in terms of the possible impact of an error or omission on the financial statements and set an overall planning materiality level. We then set a tolerable error to reduce the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality to an appropriately low level. We also assess each disclosure and consider qualitative issues affecting materiality as well as quantitative issues.

To the fullest extent permissible by auditing standards, we will seek to rely on the work of internal audit wherever possible.

Arrangements for securing economy, efficiency and effectiveness

The National Audit Office has consulted on the audit approach for the Value for Money (VFM) conclusion. The outcome was announced in November 2015, following which we confirm the impact for our audit of the Council with the Audit and Governance Committee and management and set out this impact in our audit plan.

We expect to be able to adopt an integrated audit approach, so our work in the financial statement audit feeds into our conclusion of the arrangements in place for securing economy, efficiency and effectiveness.

Further detail is included in section 4 of this Audit Plan.

2. Financial statement risks

We outline below our current assessment of the financial statement risks facing the Council, identified through our knowledge of the Council's operations and discussion with those charged with governance and officers.

At our meeting, we will seek to validate these with you.

Significant risks (including fraud risks) Our audit approach

Risk of fraud in revenue and/or expenditure recognition

Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue.

In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We will

- ▶ Review and test revenue and expenditure recognition policies
- ▶ Review and discuss with management any accounting estimates on revenue or expenditure recognition for evidence of bias
- ▶ Develop a testing strategy to test material revenue and expenditure streams
- ▶ Review and test revenue and expenditure cut-off at the period end date.

Risk of management override

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

Our approach will focus on:

- ▶ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements
- ▶ Reviewing accounting estimates for evidence of management bias, and
- ▶ Evaluating the business rationale for significant unusual transactions.

Not significant risks

Risk of understatement of Unequal Pay provision

The equal pay provision may be understated based on the estimates provided by internal legal advisors.

Our approach will focus on:

- ▶ Obtaining the schedule of unequal pay provision, and agree amounts to the general ledger accounts.
- ▶ Reviewing schedule for correctness and completeness, including whether the unequal pay provision are consistent with our understanding of the entity's business, and test recorded amounts.
- ▶ Inquiring with management around the process controls and policy that were used and implemented regarding the unequal pay provision.

Reliance on one contractor to prepare year-end financial information

The risk exists that due to the reliance on

Our approach will focus on:

one contractor with no formal contract to prepare financial information could impede the clients' ability to compile the financial statements in a timely manner. As complex spreadsheets form a crucial part of compiling the financial information there is an additional element of risk due to susceptibility to errors, either human or as a result of data corruption. Currently there is no succession or continuity plans in place for this role.

- ▶ Review any plans developed by the Council to provide continuity and succession for this work
- ▶ Obtain the spreadsheet and agree amounts to the general ledger accounts.
- ▶ Review schedule for correctness and completeness, including whether the balances are consistent with our understanding of the entity's business, underlying data and test recorded amounts.

Valuation of Property Plant and Equipment

The former Council office building is in the process of being demolished. The accounting treatment of the building was queried by the previous auditors last year and was recorded as an uncorrected misstatement in their ISA 260 report. We will review the current valuation treatment to ensure that it is materially correct.

Our approach will focus on:

- ▶ Review proposed accounting treatment in 2015/16
- ▶ Review any valuer's report on the building
- ▶ Review disclosure to ensure that it is appropriate.

Valuation of Investment Properties

The Council does not value investment properties on an annual basis as required by the CIPFA Local Government Statement of Accounting Practice.

Our approach will focus on:

- ▶ Review proposed valuation treatment in 2015/16
- ▶ Review any valuer's report on the properties
- ▶ Review disclosures to ensure that they are appropriate.

Respective responsibilities in relation to fraud and error

We would like to take this opportunity to remind you that management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- ▶ Identifying fraud risks during the planning stages;
- ▶ Enquiry of management about risks of fraud and the controls to address those risks;

- ▶ Understanding the oversight given by those charged with governance of management's processes over fraud;
- ▶ Consideration of the effectiveness of management's controls designed to address the risk of fraud;
- ▶ Determining an appropriate strategy to address any identified risks of fraud, and
- ▶ Performing mandatory procedures regardless of specifically identified risks.

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3. Economy, efficiency and effectiveness

The Local Audit and Accountability Act 2014 provided the Comptroller and Auditor General with the power to issue guidance to auditors which may explain or supplement the provisions of the Code of Audit Practice. The 2014 Act requires auditors to comply with any such guidance issued.

The National Audit Office is currently consulting on a draft guidance note regarding auditors' work in respect of their Value for Money conclusion. The consultation closed on 30 September and we expect the final guidance will be issued in November 2015 and will apply to audits from 2015/16 onwards.

The present proposals seek to:

- ▶ Build on the existing guidance, issued by the Audit Commission, evolving the approach to reflect changing circumstances for public sector organisations and the new 2015 Code of Audit Practice;
- ▶ Update the definition of 'proper arrangements' against which auditors make their judgements and better align the criteria with to the arrangements on which audited bodies are required to report;
- ▶ Remain focussed on a risk based approach whilst strengthening guidance in relation to the identification of significant risks to the VFM conclusion and the work required to address them;
- ▶ Set out more fully the range of reporting options available to auditors and set out the reporting expectations at key stages during the audit;
- ▶ Clarify the options available to auditors when issuing their statutory conclusion, where required, and how auditors might approach making judgments on whether to qualify their conclusions; and
- ▶ Maintain an element of sector specific information, helping auditors understand better the key developments and risks in the relevant sectors.

We will inform the Audit and Governance Committee and management of the outcome of this consultation, the impact on our audit approach and any change in our audit fees after the final NAO guidance has been issued.

Significant risks	Our audit approach
Delivering financial resilience	
<p>The Council is facing a challenging financial position and is reporting an overspend in both Adult and Children's Social Care and is having to plan for significant cuts in spending in future years. The recent announcement by the Government of a reduction in the Revenue Support Grant requires the Council to make further savings. The timing of the announcement in December 2016 means that the Council will revisit its 2016/17 budget and Medium Term Financial Plan. The Council may find it challenging to set a balanced budget.</p>	<p style="text-align: center;">Financial resilience</p> <p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Review of the 2015/16 outturn position against budget ▶ Assessing the robustness of processes for identifying and implementing savings ▶ Review revised 2016/17 budgets and updated Medium Term Financial Plan.

4. Our audit process and strategy

4.1 Objective and scope of our audit

Under the Code of Audit Practice our principal objectives are to review and report on the Council's:

- ▶ Financial statements
- ▶ Arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

i **Financial statement audit and regularity audit**

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK and Ireland).

We report to you by exception in respect of your governance statement, and other accompanying material as required, in accordance with relevant guidance prepared by the NAO on behalf of the Comptroller and Auditor General.

Alongside our audit report, we also:

- ▶ Review and report to the NAO on the Whole of Government Accounts return to the extent and in the form they require;

ii **Arrangements for securing economy, efficiency and effectiveness**

As previously noted, the specific requirements for our Value for Money audit are expected to be confirmed in November 2015.

4.2 Audit process overview

Analytics

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- ▶ Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests
- ▶ Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit and Governance Committee.

Internal audit

We will review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where we raise issues that could have an impact on the year-end financial statements.

Use of experts

We will use specialist EY resource as necessary to help us to form a view on judgments made in the financial statements. Our plan currently includes involving specialists in pensions, valuations, financial reporting and tax.

Mandatory procedures required by auditing standards

As well as the financial statement risks outlined in section three, we must perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- ▶ Addressing the risk of fraud and error;
- ▶ Significant disclosures included in the financial statements;
- ▶ Entity-wide controls;
- ▶ Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements;
- ▶ Auditor independence.

Procedures required by the Code

- ▶ Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Governance Statement.
- ▶ Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO.
- ▶ Satisfying ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Finally, we are also required to discharge our statutory duties and responsibilities as established by the Local Audit and Accountability Act 2014.

4.3 Materiality

For the purposes of determining whether the financial statements are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in aggregate, could reasonably be expected to influence the users of the financial statements. Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition.

We have determined the proposed overall materiality for the financial statement of the Council is £8,272,000 based on 2% of gross expenditure. We will communicate uncorrected audit misstatements greater than £414,000 to you. These figures and levels are currently being reviewed within EY, if changes are made as a result of this review they will be communicated in a timely manner.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all the circumstances that might ultimately influence our judgement. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

4.4 Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code. The indicative fee scale for the audit of Reading Borough Council is £108,938 with an estimated fee of £20,187 for the certification of the housing benefit subsidy claim.

4.5 Your audit team

The engagement team is led by Maria Grindley, who is currently on sabbatical. While she is on sabbatical she will be supported by another Executive Director from our Reading office, Paul King. Both Maria and Paul have significant experience of auditing local government clients. They are supported by Alan Witty as senior manager who is responsible for the day-to-day direction of audit work and is the key point of contact for the Corporate Finance Business Partner.

4.6 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit, including the VFM work and the Whole of Government Accounts. The timetable includes the deliverables we have agreed to provide to the Council through the Audit and Governance Committee's cycle in 2015/16. These dates are determined to ensure our alignment with PSAA's rolling calendar of deadlines.

From time to time matters may arise that require immediate communication with the Audit and Governance Committee and we will discuss them with the Chair as appropriate.

Following the conclusion of our audit we will prepare an Annual Audit Letter to communicate the key issues arising from our work to the Council and external stakeholders, including members of the public.

Audit phase	Timetable	Audit and Governance Committee timetable	Deliverables
High level planning	April 2015	April 2015	Audit Fee letter Progress Report
Risk assessment and setting of scopes	December 2015	January 2016	Audit Plan
Testing routine processes and controls	February-March 2016	April 2016	Progress Report
Year-end audit	July-August 2016		
Completion of audit	August 2016	September 2016	Report to those charged with governance via the Audit Results Report Audit report (including our opinion on the financial statements; [our opinion on the regularity of your expenditure and income]; and, [by exception] overall value for money conclusion).

Audit completion certificate
Reporting to the NAO on the Whole of
Government Accounts return.

Conclusion of reporting	By 31 October 2016	December 2016	Annual Audit Letter
Reporting on Housing Benefit	November 2016	January 2017	Annual Grant Claim Report

In addition to the above formal reporting and deliverables we will seek to provide practical business insights and updates on regulatory matters.

5. Independence

5.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 260 'Communication of audit matters with those charged with governance', requires us to communicate with you on a timely basis on all significant facts and matters that bear on our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we do this formally both at the planning stage and at the conclusion of the audit, as well as during the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications

Planning stage	Final stage
<ul style="list-style-type: none"> ▶ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between you, your affiliates and directors and us; ▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality Review; ▶ The overall assessment of threats and safeguards; ▶ Information about the general policies and process within EY to maintain objectivity and independence. 	<ul style="list-style-type: none"> ▶ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▶ Details of non-audit services provided and the fees charged in relation thereto; ▶ Written confirmation that we are independent; ▶ Details of any inconsistencies between APB Ethical Standards, the PSAA Terms of Engagement and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ▶ An opportunity to discuss auditor independence issues.

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, for example when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future contracted services, and details of any written proposal to provide non-audit services;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period are disclosed and analysed in appropriate categories.

5.2 Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including any principal threats. However we have adopted the safeguards below to mitigate these threats along with the reasons why they are considered to be effective.

Self-interest threats

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with the Council.

At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services, and we will comply with the policies that the Council has approved and that are in compliance with the Audit Commission's Standing Guidance.

A self-interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to the Council. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in compliance with Ethical Standard 4.

There are no other self-interest threats at the date of this report.

Self-review threats

Self-review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no other self-review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions based on that work.

There are no management threats at the date of this report.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

Overall Assessment

Overall we consider that the adopted safeguards appropriately mitigate the principal threats identified, and we therefore confirm that EY is independent and the objectivity and independence of Paul King and Maria Grindley, the audit engagement directors and the audit engagement team have not been compromised.

5.3 Other required communications

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes within EY for maintaining objectivity and independence can be found in our annual Transparency Report, which the firm is required to publish by law. The most recent version of this report is for the year ended June 2015 and can be found here:

<http://www.ey.com/UK/en/About-us/EY-UK-Transparency-Report-2015>

Appendix A Fees

A breakdown of our agreed fee is shown below.

	Planned Fee 2015/16 £	Scale fee 2015/16 [current year] £	Outturn fee 2014/15 [prior year] £	Explanation
Opinion Audit and VFM Conclusion	£108,938	£108,938	£145,250	
Total Audit Fee – Code work	£108,938	£108,938	£145,250	
Certification of claims and returns ¹	£20,187	£20,187	20,130	
Non-audit work	0	0	0	

All fees exclude VAT.

The agreed fee presented above is based on the following assumptions:

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ The operating effectiveness of the internal controls for the key processes outlined in section 4.2 above;
- ▶ We can rely on the work of internal audit as planned;
- ▶ The NAO making no significant changes to the final value for money guidance on which our conclusion will be based;
- ▶ Our accounts opinion and value for money conclusion being unqualified;
- ▶ Appropriate quality of documentation is provided by the Council; and
- ▶ The Council has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.

¹ Our fee for the certification of grant claims is based on the indicative scale fee set by the Audit Commission and PSAA..

Appendix B UK required communications with those charged with governance

There are certain communications that we must provide to the Audit and Governance Committee. These are detailed here:

Required communication	Reference
<p>Planning and audit approach</p> <p>Communication of the planned scope and timing of the audit including any limitations.</p>	<ul style="list-style-type: none"> ▶ Audit Plan
<p>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Significant difficulties, if any, encountered during the audit ▶ Significant matters, if any, arising from the audit that were discussed with management ▶ Written representations that we are seeking ▶ Expected modifications to the audit report ▶ Other matters if any, significant to the oversight of the financial reporting process 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ In writing, corrected misstatements that are significant 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Fraud</p> <ul style="list-style-type: none"> ▶ Enquiries of the Audit and Governance Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▶ A discussion of any other matters related to fraud 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Related parties</p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the entity 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>External confirmations</p> <ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Consideration of laws and regulations</p> <ul style="list-style-type: none"> ▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This 	<ul style="list-style-type: none"> ▶ Report to those charged with governance

Required communication	Reference
<p>communication is subject to compliance with legislation on tipping off</p> <ul style="list-style-type: none"><li data-bbox="352 344 1155 465">▶ Enquiry of the Audit and Governance Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit and Governance Committee may be aware of.	

Required communication	Reference
<p>Independence</p> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement director's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence 	<ul style="list-style-type: none"> ▶ Audit Plan ▶ Report to those charged with governance
<p>Going concern</p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Significant deficiencies in internal controls identified during the audit</p>	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Fee Information</p> <ul style="list-style-type: none"> ▶ Breakdown of fee information at the agreement of the initial audit plan ▶ Breakdown of fee information at the completion of the audit 	<ul style="list-style-type: none"> ▶ Audit Plan ▶ Report to those charged with governance ▶ Annual Audit Letter if considered necessary
<p>Opening Balances</p> <ul style="list-style-type: none"> ▶ Findings and issues regarding the opening balance of initial audits 	<p>Report to those charged with governance</p>
<p>Certification work</p> <ul style="list-style-type: none"> ▶ Summary of certification work undertaken 	<p>Annual Report to those charged with governance summarising grant certification.</p>

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