

A photograph of a meeting table with documents and hands pointing at them. The table is white, and there are several sheets of paper with text on it. A person's hand is pointing at a document on the left, and another person's hand is pointing at a document on the right. A smartphone is visible on the table. The background is slightly blurred, showing a person in a yellow shirt.

# Reading Borough Council

## Draft Audit planning report

Year ended 31 March 2018

27 January 2020

27 January 2020



Dear Audit & Governance Committee Members

#### Audit planning report

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as your auditor. Its purpose is to provide the Audit & Governance Committee with a basis to review our proposed audit approach and scope for the 2017/18 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.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of the Audit & Governance Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 30 January 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Maria Grindley

Associate Partner

For and on behalf of Ernst & Young LLP

# Contents



Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (<https://www.psa.co.uk/audit-quality/statement-of-responsibilities/>). 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 and further guidance (updated April 2018)" issued by the 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 in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit & Governance Committee and management of Reading Borough Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit & Governance Committee, and management of Reading Borough Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit & Governance Committee and management of Reading Borough Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



01

# Overview of our 2017/18 audit strategy



# Overview of our 2017/18 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit & Governance Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

## Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Risk of fraud in revenue and expenditure recognition - incorrect capitalisation of revenue	Fraud risk/ Significant risk	No change in risk or focus	Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. 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.
Qualified Accounts 2016/17 - Income and Expenditure; Debtors and Creditors	Significant risk	Change in risk or focus	The 2016/17 audit resulted in a qualified audit opinion on a number of different significant accounts: Income and Expenditure, Debtors and Creditors and also Pensions (IAS 19) Scheme Assets. The qualification arose, in the main, as a result of material errors and uncertainties arising from the audit in 2016/17. A number of these arose from historical system issues. We will need to revisit these areas as part of the 2017/18 and to understand these accounts. We also need to consider the opening balances on these accounts, where applicable, as the inability to gain assurance over the closing balances in 2016/17 will also have implications for the opening balances in 2017/18. We deal with the Pensions issue separately below as a separate Significant Risk.
Completion of the cash and bank and control account reconciliations	Significant risk	No change in risk or focus	In the prior year audit we noted that the completion of the cash and bank and control account reconciliations was not done properly or timely. We consider the timely completion of the cash and bank and control account reconciliations as important controls that help to ensure sound financial control.
IAS 19 Assurance Process, Pension liabilities and the IAS 19 valuations	Significant risk	Change in risk or focus	As part of the assurance process in place between auditors there is an agreed process for the provision of information between of the auditors of the Pension Fund administrator and the auditors of admitted bodies of the Pension Fund. Reading Borough Council is an admitted body of the Royal Berkshire Pension Fund which in 2017/18 was audited by KPMG. KPMG are no longer the auditor of the Royal Berkshire Pension Fund and therefore there may be issues in receiving the required assurances. The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme with administration provided by Royal Borough of Windsor and Maidenhead on behalf of the Royal Berkshire Pension Fund. The Council uses the services of Barnett Waddingham, an actuarial expert, to support them with the actuarial assumptions and disclosures supporting the IAS 19 figures.

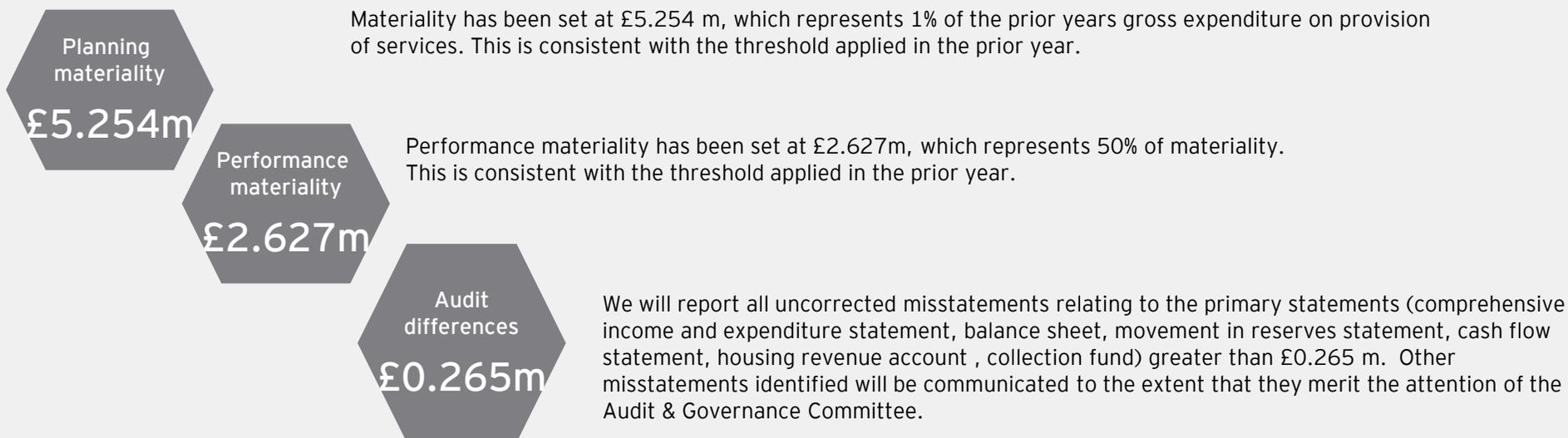
## Overview of our 2017/18 audit strategy

### Audit risks and areas of focus (continued)

Risks	Risk identified	Change from PY	Details
Valuations of Property, Plant and Equipment (PPE) and Investment Property (IP)	Inherent risk	No change in risk or focus	The carrying amount of PPE and the fair value of IP represent significant balances in the Council's accounts and are subject to impairment reviews, depreciation charges and valuation changes, respectively. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. There is an inherent risk of material misstatement.
All accounts	Inherent risk	No change in risk or focus	Given the significant issues identified during the 2016/17 audit and the resultant qualified opinion we have attached an inherent risk across all accounts to ensure that we attach the correct risk profile to the 2017/18 accounts.

# Overview of our 2017/18 audit strategy

## Materiality



# Overview of our 2017/18 audit strategy

## Audit scope

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 2018 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

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.



# 02 Audit risks



## Our response to significant risks

**Risk of fraud in revenue and expenditure recognition - Inappropriate capitalisation of revenue expenditure**

### Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts.

As identified in ISA (UK) 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.

### What is the risk?

Local authorities have a statutory duty to balance their annual budget and are operating in a financially challenged environment with reducing levels of government funding and increasing demand for services.

Achievement of budget is critical to minimizing the impact and usage of the Council's usable reserves and provides a basis for the following year's budget. Any deficit outturn against the budget is therefore not a desirable outcome for the Council and management, and therefore this desire to achieve the budget increases the risk that the financial statements may be materially misstated.

Whilst there is no more than normal pressure on the Council to meet the outturn position, due to the size of the capital programme there is a risk of inappropriate capitalisation of revenue expenditure.

### What will we do?

- ▶ Review of the capital programme to assess what schemes are included and identify anything unusual or unexpected;
- ▶ Review capital expenditure incurred by the Council to ensure that it has been correctly classified as capital rather than revenue; and
- ▶ We will specifically test PPE additions with a specific focus on incorrect capitalisation of revenue expenditure.

In addition to the above, our audit procedures in relation to fraud and error also include review of:

- Journal entries; specifically manual journals posted by management in the preparation of the financial statements.
- Significantly unusual transactions entered into by management that are outside of the normal scope of business of the Council; and
- Management bias in key accounting estimates and judgements.

## Our response to significant risks (continued)

**Impact of Qualified Accounts from 2016/17 - Income and Expenditure, Debtors and Creditors**

### Financial statement impact

Income: £450 m  
 Expenditure: £493 m  
 Short term Debtors: £23 m  
 Short term Creditors: £67 m

### What is the risk?

The 2016/17 audit was significantly delayed due to significant internal control issues identified as part of the audit. As a result the certification date of 30<sup>th</sup> September 2017 was missed with final certification on the audit taking place in July 2019.

The audit opinion was also qualified across the key significant accounts: Income and Expenditure; Debtors; Creditors; and Pensions (IAS 19) Scheme Assets.

These specific accounts were qualified in 2016/17 as we were unable to obtain sufficient appropriate audit evidence to confirm that these accounts were materially correct.

We will need to consider these accounts again as part of the 2017/18 audit. We would also note that where any of these accounts have a Balance Sheet impact then we would also need to qualify the opening balances as part of the 2017/18 audit given the fact that we were unable to satisfy ourselves on the material nature of the closing 2016/17 balances.

### What will we do?

Our approach will focus on:

- ▶ Considering any brought forward closing balances from 2016/17 and the impact on qualification of opening balances for 2017/18 where appropriate;
- ▶ Designing our substantive testing procedures to understand how we can test these balances and obtain the appropriate audit evidence required. This will involve testing at appropriate thresholds which reflect the increased risk profile of these accounts and the associated significant risk.
- ▶ We will isolate areas of Income and Expenditure, such as grants and payroll, where we were able to obtain appropriate assurance in 2016/17 and focus our testing on areas where we had particular issues in 2016/17. This will include for example a focus on recharges and also on other service income and expenditure; and
- ▶ Seeking assurances from management as to what they have done since the 2016/17 audit to address the deficiencies highlighted in our prior year audit results report and following up on the status of any recommendations made as part of the prior year audit.

## Our response to significant risks (continued)

IAS 19 Assurance Process,  
Pension liabilities and the IAS  
19 valuations

### Financial statement impact

IAS 19 Liability: £451 m

### What is the risk?

As part of the formal protocol between the auditors of local government Pension Funds and the auditors of local government admitted member bodies to the Pension Fund a formal letter is issued to the auditor of the Pension Fund by the auditor of the admitted body requesting a programme of work and testing to be undertaken and formally reported back.

For the period in question (i.e. 1 April 2017 to 31 March 2018) the auditor of the Berkshire Pension Fund was KPMG LLP. KPMG LLP are no longer the auditor of the Royal Berkshire Pension Fund.

Initial correspondence with KPMG has indicated that as they are no longer the Pension Fund auditor then they are not in a position to provide EY, as external auditor to Reading Borough Council, with the relevant IAS 19 Assurance Letter for 2017-18. This is due to the fact that they no longer have access to the data.

This leaves EY unable to take the significant assurance which the IAS 19 Assurance Letter offers. This includes for example information in respect of the :

- The control environment at the Pension Fund;
- Testing completed at the Royal Berkshire Pension Fund specifically at the request of EY on their testing of investment assets including harder to value Level 3 assets; and
- Consideration of any deficiencies noted.

In the prior year we also qualified this account specifically on the IAS 19 (Pensions) Scheme Assets.

### What will we do?

Our approach will focus on:

- Liaising with KPMG as the previous auditor and also Deloitte as the new auditor of the Pension Fund to understand what assurance can be obtained and to obtain assurances over the information supplied to the actuary in relation to Reading Borough Council
- Liaising with senior officers to understand what evidence they may be able to obtain in respect of the testing undertaken at the Royal Berkshire Pension Fund in 2017/18;
- Understanding the nature of any possible alternative procedures that could be applied. This would also consider the extent of the testing required to obtain the requisite assurance and also the cost and time implications of any such procedures;
- Assessing the work of the Pension Fund actuary (Barnett Waddingham Actuary) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team;
- Reviewing and testing the accounting entries and disclosures made within the Council's financial statements in relation to IAS19; and
- Assessing the possible impact of the McCloud judgement on the 2017/18 accounts and consideration of any possible adjustment through an adjusting Post-Balance Sheet event.

## Audit risks

# Our response to significant risks (continued)

IAS 19 Assurance Process,  
Pension liabilities and the IAS  
19 valuations (cont'd)

### Financial statement impact

IAS 19 Liability: £451 m

### What is the risk?

The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Royal Berkshire Pension Fund.

The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2018 this net liability totalled £447 million.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Berkshire Pension Fund.

Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

We are also aware of an issue which emerged in 2018/19 which could have been applicable to the closure of the 2017/18 accounts given the delay in closing the 2016/17 accounts and the subsequent impact on the 2017/18 accounts preparation. This is commonly referred to as the McCloud judgement and has impacted significantly across local government.

## Audit risks

# Our response to significant risks

We have set out the significant risks (including fraud risks denoted by\*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

	What is the risk?	What will we do?
<b>Completion of Cash &amp; Bank and Control Account Reconciliations</b>	<p>We are aware from our work completed in 2015/16 and 2016/17 that the completion of the bank account reconciliations was not done properly or timely during 2016/17 and for the majority of 2017/18. We highlighted this as a Significant Risk in previous years. We spent a lot of time reviewing the cash balances in the Statement of Accounts changed significantly before we were satisfied with it.</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"><li>- Reviewing reconciliations to ensure that they are being completed and reviewed in a timely manner;</li><li>- Ensuring that balancing items are cleared on a regular basis and are not carried from one reconciliation to another without good cause;</li><li>- Confirming that reviews are carried out on a timely basis and are evidenced on completion;</li><li>- Seeking assurances from management as to what they have done since the 2016/17 audit to address the deficiencies highlighted in our audit results report and following up on the status of any recommendations we made as part of the prior year audit;</li><li>- Informing management of any concerns when they arise; and</li><li>- Following up on the statutory recommendations we raised in this area in 2016/17.</li></ul>
<b>Financial statement impact</b>  Cash: £22 m Short Term Debtors: £23 m Short Term Creditors: £67 m	<p>We also found that completion and review of control accounts was not timely during 2016/17 and for the majority of 2017/18.</p> <p>We consider the timely completion and review of the bank and control account reconciliations as important controls that help to ensure financial control.</p>	

## Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

### What is the risk/area of focus?

#### Valuation of Land and Buildings

The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

### What will we do?

We will:

- ▶ Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- ▶ Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre);
- ▶ Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE and annually for IP. We will also consider if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;
- ▶ Review assets not subject to valuation in 2017/18 to confirm that the remaining asset base is not materially misstated;
- ▶ Consider changes to useful economic lives as a result of the most recent valuation; and
- ▶ Test accounting entries have been correctly processed in the financial statements.

## Audit risks

### Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

#### What is the risk/area of focus?

##### All Accounts

We experienced significant delays in completing our audit of the Statement of Accounts in 2015/16 and 2016/17. Both audits missed the certification date with the 2016/17 audit significantly delayed and finally certified with a qualified opinion in July 2019.

We experienced delays in receiving the working papers we needed and the required supporting information. We raised a number of recommendations in our Audit Results Report and management have committed to improve performance this year.

We updated our 2016/17 audit strategy in January 2018 to reflect the increased risk profile of the audit arising from the significant issues and errors we were experiencing during the audit. This was a new Other Area of Audit Focus with a specific consideration of All Accounts (excluding any specific accounts where we had already attached a Significant Risk).

We believe that given the systemic and inherent nature of these issues it is valid to continue this risk assessment into the 2017/18 audit.

#### What will we do?

We will:

- ▶ Review all accounts (excluding those previously detailed as Significant Risk) as having an Inherent Risk. This will enable our teams to assess each significant account with the appropriate level of professional scepticism. It will also ensure that our testing is focused at the correct risk level to reflect our wider assessment of the control environment;
- ▶ Involve a technical reviewer from our Financial Reporting Group to complete a review of the draft 2017/18 accounts. This will provide the on site audit team with further support and also ensure that the draft accounts are materially compliant with all relevant standards and the CIPFA Code. The findings from this review will be shared with the Council and we will need supporting responses which are suitably detailed to address these findings. This approach is consistent with the prior year.; and
- ▶ We will also involve a peer review Partner on the engagement to support the audit team in addressing any issues identified during the engagement. This approach is consistent with the prior year.



03

# Value for Money Risks





## Background

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

For 2017/18 this is based on the overall evaluation criterion:

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

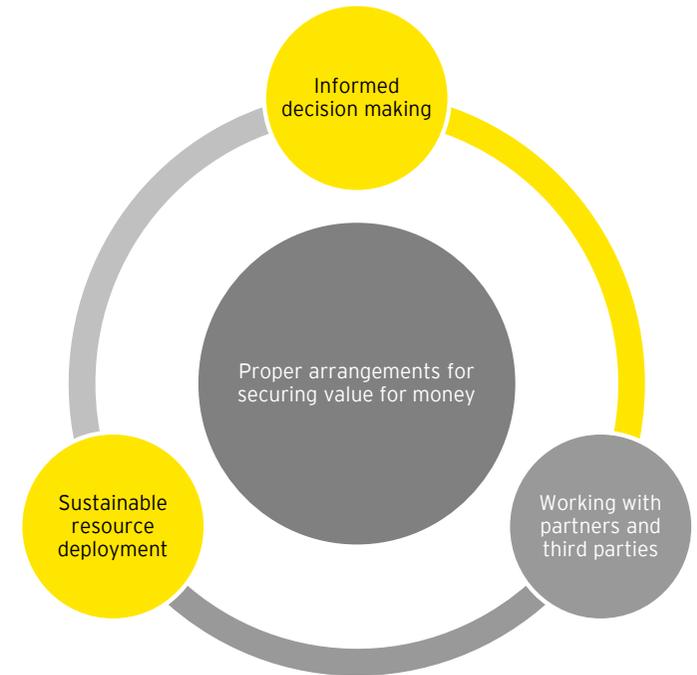
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2018/19 this has included consideration of the steps taken by the Authority to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Authorities will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of the significant risk noted on the following page which we view as relevant to our value for money conclusion.





## Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
<p>In February 2017 we issued Section 24 Schedule 7(2) Statutory Recommendations covering a number of areas. In 2016/17 the value for money conclusion was qualified due to the issues arising and identified in our report.</p> <p>Whilst we can see progress being made and changes coming through at the Council, a number of the issues in our report and covered by the recommendations still existed during the 2017/18 financial year. We therefore need to consider what progress was made during the year and the impact on our report.</p>	<p>Take informed decisions / Deploy resources in a sustainable manner/ Work with partners and other third parties</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"><li>• Revisiting the recommendations made as part of the 2016/17 audit to understand the Council's progress against these;</li><li>• Reviewing the financial resilience of the Council with reference to the Medium Term Financial Plan, considering any budget gaps in that period and considering the Council's position in respect of Usable Reserves.</li><li>• Considering the Council's outturn position in 2017/18 and considering the impact of the financial outturn on the Reserves balances.</li><li>• Considering any regulatory findings from key inspectorates, such as Ofsted, with a view to understanding other non-financial performance.</li></ul>



04

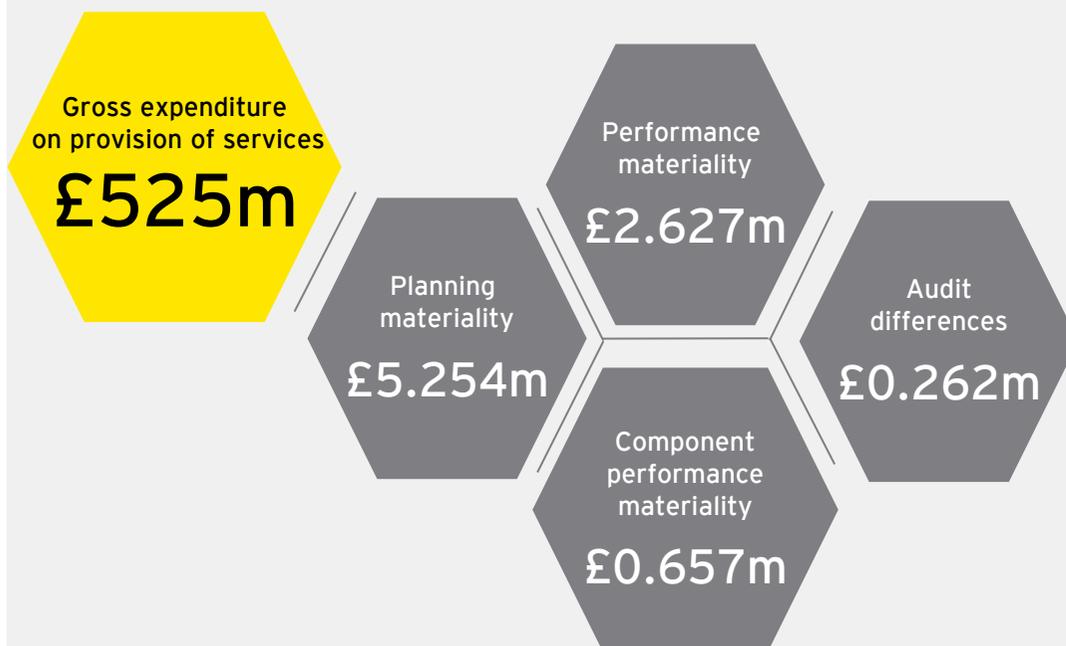
# Audit materiality



# Materiality

## Materiality

For planning purposes, materiality for 2017/18 has been set at £5.254 m. This represents 1% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process.



We request that the Audit & Governance Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

## Key definitions

**Planning materiality** - the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

**Performance materiality** - the amount we use to determine the extent of our audit procedures. We have set performance materiality at £2.627m which represents 50% of planning materiality. We have set the 50% threshold based on the issues noted in 2016/17 and also to reflect the anticipated errors in 2017/18.

**Component performance materiality range** - we determine component performance materiality as a percentage of Group performance materiality based on risk and relative size to the Group.

**Audit difference threshold** - we propose that misstatements identified below this threshold are deemed clearly trivial. The same threshold for misstatements is used for component reporting. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, housing revenue account and collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the audit & governance committee, or are important from a qualitative perspective.

**Specific materiality** - We may set a materiality lower than that specified for specific accounts for e.g. remuneration disclosures, related party transactions, and exit packages which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this. If this is the case we will confirm this in our Audit Results Report.



05

## Scope of our audit



## Our Audit Process and Strategy

### Objective and Scope of our Audit scoping

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

#### 1. Financial statement audit

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

We also 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; and
- Auditor independence.

#### Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO [delete if not applicable]

#### 2. Arrangements for securing economy, efficiency and effectiveness (value for money)

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

## Our Audit Process and Strategy (continued)

### Audit Process Overview

Our audit involves:

- ▶ Identifying and understanding the key processes and internal controls; and
- ▶ Substantive tests of detail of transactions and amounts.

For 2017/18 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

#### 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; and
- ▶ 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 & Governance Committee.

#### Internal audit:

We will regularly meet with the Head of Internal Audit, and 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 they raise issues that could have an impact on the financial statements.

# Scope of our audit

## Scoping the group audit

### Group scoping

Our audit strategy for performing an audit of an group with subsidiaries is risk based. We identify components as:

- 1. Significant components:** A component is significant when it is likely to include risks of material misstatement of the group financial statements, either because of its relative financial size to the group (quantitative criteria), or because of its specific nature or circumstances (qualitative criteria). We generally assign significant components a full or specific scope given their importance to the financial statements.
- 2. Not significant components:** The number of additional components and extent of procedures performed depended primarily on: evidence from significant components, the effectiveness of group wide controls and the results of analytical procedures.

### Scoping by Entity

Our preliminary audit scopes by number of entities we have adopted are set out below.

1	A	Full scope audits
0	B	Specific scope audits
0	C	Review scope audits
0	D	Specified procedures
4	E	Other procedures

### Scope definitions

**Full scope:** locations where a full audit is performed to the materiality levels assigned by the Group audit team for purposes of the consolidated audit. Procedures performed at full scope locations support an interoffice conclusion on the reporting package. These may not be sufficient to issue a stand-alone audit opinion on the local statutory financial statements because of the materiality used and any additional procedures required to comply with local laws and regulations.

**Specific scope:** locations where the audit is limited to specific accounts or disclosures identified by the Group audit team based on the size and/or risk profile of those accounts.

**Review scope:** locations where procedures primarily consist of analytical procedures and inquiries of management. On-site or desk top reviews may be performed, according to our assessment of risk and the availability of information centrally.

**Specified Procedures:** locations where the component team performs procedures specified by the Group audit team in order to respond to a risk identified.

**Other procedures:** For those locations that we do not consider material to the Group financial statements in terms of size relative to the Group and risk, we perform other procedures to confirm that there is no risk of material misstatement within those locations.

## Scoping the group audit (continued)

### Group audit team involvement in component audits

Auditing standards require us to be involved in the work of our component teams. We have listed our planned involvement below.

- During the audit period of the 2017/18 accounts, we will visit the entity subject to a full scope audit and incorporate a combination of review of the component team's audit work and meeting with business unit management. For the purposes of our Group scoping Reading Transport Limited (RTL) is deemed to be a significant component and subject to full scope procedures.
- For all other components we perform other procedures to confirm that there is no risk of material misstatement within those entities. The not significant components are: Reading Economic Development Company (REDCO) Limited; ACRE Road Industrial Estate Limited (ARIEL); Queen's Road Car Park Limited (QRCPL); Reading Hampshire Property Partnership.

The procedures we will perform on these entities are detailed below.

- Review of group wide entity level controls over these components, including the level management oversight and results of Internal Audit visits, if any.
- Perform analytical review procedures on the components' yearend accounts.
- Test consolidation journals and intercompany eliminations.
- Enquiry of management about unusual transactions in these components.
- Review of management's reconciliation of local statutory accounts to prior year group accounts

Audit Scope	Planned involvement by the Group team
Entity under full scope	Full scope entity will participate in the review of the component's audit work by Group audit team during the visit and discussion of significant findings noted by the component team.
Entities subject to other procedures	Performance of the procedures discussed above for entities subject to other procedures



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## Audit team



## Audit team

**Audit team structure:**



Internal Specialist  
EY Pensions

\* Key Audit Partner

## Audit team

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### Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	Sanderson Wetherall (external valuers)
Pensions disclosure	EY Actuaries, KPMG, Deloitte, Barnett Waddingham
PFI	Arlingclose

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- ▶ Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- ▶ Assess the reasonableness of the assumptions and methods used;
- ▶ Consider the appropriateness of the timing of when the specialist carried out the work; and



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## Audit timeline





# Audit timeline

## Indicative timetable of communication and deliverables

### Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

From time to time matters may arise that require immediate communication with the Audit & Governance Committee and we will discuss them with the Audit & Governance Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Audit & Governance Committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	September - October		
Walkthrough of key systems and processes	November-December		
Interim audit testing	January	Audit & Governance Committee	Audit Planning Report
Year end audit	January - March		
Audit Completion procedures	April	Audit & Governance Committee	Audit Results Report Audit opinions and completion certificates
	May		
	June	Audit & Governance Committee	Annual Audit Letter
	July		
	August - October		



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Independence



## Introduction

The FRC Ethical Standard and ISA (UK) 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 upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of 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"> <li>▶ The principal threats, if any, to objectivity and independence identified by Ernst &amp; Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;</li> <li>▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;</li> <li>▶ The overall assessment of threats and safeguards;</li> <li>▶ Information about the general policies and process within EY to maintain objectivity and independence.</li> <li>▶ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard [note: additional wording should be included in the communication reflecting the client specific situation]</li> </ul>	<ul style="list-style-type: none"> <li>▶ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose 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;</li> <li>▶ Details of non-audit services provided and the fees charged in relation thereto;</li> <li>▶ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us;</li> <li>▶ Written confirmation that all covered persons are independent;</li> <li>▶ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy;</li> <li>▶ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and</li> <li>▶ An opportunity to discuss auditor independence issues.</li> </ul>

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, 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 services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

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, analysed in appropriate categories, are disclosed.

## 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 the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non-audit services if the service has been pre-approved in accordance with your policy.

### Overall Assessment

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

### Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include 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 you. At the time of writing, we are in the process of agreeing the final 2016/17 audit and have provided detail submissions to the Public Sector Audit Appointments Ltd as part of an agreed process for discussing Scale Fee Variations. We have also supplied further information to management as part of the agreement of the audit fee for 2016/17.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, the current ratio of non-audit fees to audit fees is approximately 12%. No additional safeguards are required.

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 you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

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

## Relationships, services and related threats and safeguards

### 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 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 the Council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision 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.

## Other communications

### EY Transparency Report 2017

Ernst & Young (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 in place 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 1 July 2018 and can be found here:

<https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018>



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## Appendices



## Appendix A

### Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2017/18 accounts.

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 requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Planned fee 2017/18	Scale fee 2017/18	Final Fee 2016/17
	£	£	£
Total Fee - Code work	108,938**	108,938	*
Other - Housing Benefits	34,591	34,591	17,470
<b>Total audit</b>	<b>143,529</b>	<b>143,529</b>	
Other non-audit services: Housing Capital Receipts	6,500***	6,500	6,000
Other non-audit services: Teacher's Pensions	10,000	10,000	10,000
<b>Total other non-audit services</b>	<b>16,500</b>	<b>16,500</b>	<b>16,000</b>
<b>Total fees</b>	<b>0</b>	<b>160,029</b>	

The agreed fee presented is based on the following assumptions:

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ 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.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

- *Extensive significant delays in completion of the 2016/17 accounts. Fee agreed with PSAA and submissions made to senior officers*
- *\*\* Given the significant issues identified in 2016/17 and the nature of the qualifications we anticipate that there will be additional fee in 2017/18. We will continue to update Audit & Governance and senior officers as the audit progresses*
- *\*\*\* Housing Capital Receipts for 2017/18 is still subject to completion. All other claims and returns have been completed and certified*

## Appendix B

# Required communications with the Audit & Governance Committee

We have detailed the communications that we must provide to the Audit & Governance Committee.

### Our Reporting to you

Required communications	 What is reported?	  When and where
Terms of engagement	Confirmation by the Audit & Governance Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report presented to the January 2020 Audit & Governance Committee
Significant findings from the audit	<ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process.</li> </ul>	Audit results report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee

## Appendix B

# Required communications with the Audit & Governance Committee (continued)

 Our Reporting to you		
Required communications	 What is reported?	 When and where
Going concern	<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"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee
Misstatements	<ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ Corrected misstatements that are significant</li> <li>▶ Material misstatements corrected by management</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee
Fraud	<ul style="list-style-type: none"> <li>▶ Enquiries of the Audit &amp; Governance Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee
Related parties	<ul style="list-style-type: none"> <li>▶ Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</li> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee

## Appendix B

# Required communications with the Audit & Governance Committee (continued)

		 Our Reporting to you
<b>Required communications</b>	 <b>What is reported?</b>	 <b>When and where</b>
Independence	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats</li> <li>▶ Safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguard.</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence.</li> </ul>	<p>Audit planning report presented to the January 2020 Audit &amp; Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit &amp; Governance Committee</p>

## Appendix B

# Required communications with the Audit & Governance Committee (continued)

		Our Reporting to you
Required communications	 What is reported?	 When and where
External confirmations	<ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	Draft audit results report to be presented to the April 2020 Audit & Governance Committee
Consideration of laws and regulations	<ul style="list-style-type: none"> <li>▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>▶ Enquiry of the Audit &amp; 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 &amp; Governance Committee may be aware of.</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee
Internal controls	<ul style="list-style-type: none"> <li>▶ Significant deficiencies in internal controls identified during the audit</li> </ul>	Draft audit Results Report to be presented at the April 2020 Audit & Governance Committee
Group audits	<ul style="list-style-type: none"> <li>▶ An overview of the type of work to be performed on the financial information of the components</li> <li>▶ An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components</li> <li>▶ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work</li> <li>▶ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted</li> <li>▶ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee

## Appendix B

# Required communications with the Audit & Governance Committee (continued)

		 Our Reporting to you
Required communications	 What is reported?	 When and where
Representations	Written representations we are requesting from management and/or those charged with governance	Draft audit results report presented to the April 2020 Audit & Governance Committee
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Draft audit results report presented to the April 2020 Audit & Governance Committee
Auditors report	<ul style="list-style-type: none"> <li>▶ Any circumstances identified that affect the form and content of our auditor's report</li> </ul>	Draft audit results report presented to the April 2020 Audit & Governance Committee
Fee Reporting	<ul style="list-style-type: none"> <li>▶ Breakdown of fee information when the audit plan is agreed</li> <li>▶ Breakdown of fee information at the completion of the audit</li> <li>▶ Any non-audit work</li> </ul>	Audit planning report presented to the January 2020 Audit & Governance Committee; and draft Audit Results Report to be presented at the April 2020 Audit & Governance Committee
Certification work	Summary of certification work undertaken	Certification report to be presented to the April 2020 Audit & Governance Committee

## Additional audit information

### Other required procedures during the course of the audit

In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

#### Our responsibilities required by auditing standards

- ▶ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- ▶ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group and Council's internal control.
- ▶ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ▶ Concluding on the appropriateness of management's use of the going concern basis of accounting.
- ▶ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- ▶ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group & Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the Audit & Governance Committee reporting appropriately addresses matters communicated by us to the Audit & Governance Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- ▶ Maintaining auditor independence.

## Additional audit information (continued)

### Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines:

- ▶ The locations at which we conduct audit procedures to support the opinion given on the Group financial statements; and
- ▶ The level of work performed on individual account balances and financial statement disclosures.

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 of the circumstances that may ultimately influence our judgement about materiality. 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 accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.