Report to the Audit Committee

LONDON BOROUGH OF BARNET COUNCIL

Updates to Audit Planning Report: year ending 31 March 2020

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WELCOME

The emergence and spread of Coronavirus has had an effect on business and markets around the world. The Financial Reporting Council and other regulators have issued guidance to assist in identifying the potential financial reporting and auditing issues and consequences of the virus.

We have reviewed our initial audit plan and audit risks (dated 22 January) in response to this guidance and have amended our risks as noted in red text on the following pages.

This includes consideration of the RICS guidance to valuers on material uncertainties over valuations of land and buildings, increasing the estimation risks around impairment for non-collection of receivables, and an additional risk around going concern disclosures.

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AUDIT RISKS OVERVIEW

Executive summary

Risks identified	Risk rating	Fraud risk present	Testing approach	Impact of significant judgements and estimates
1. Management override of controls	Significant	Yes	Substantive	Medium
2. Recognition of grant income	Significant	Yes	Substantive	Medium
3. Expenditure cut-off	Significant	Yes	Substantive	Low
4. Valuation of PPE and investment property	Significant	No	Substantive	High and material uncertainty over valuations
5. Valuation of pension liability	Significant	No	Substantive	High
6. Consolidation of group entities	Significant	No	Substantive	Low
7. Allowance for non-collection of receivables	~~Normal~~ Significant	No	Substantive	~~Medium~~ High
8. Related party transactions	Normal	No	Substantive	Low
9. Going concern	Significant	No	Substantive	Medium
10. Sustainable finances	Significant	No	Detailed review of MTFS and savings plans	Medium

VALUATION OF PPE AND INVESTMENT PROPERTY

The valuation of land, buildings, dwellings and investment property is a significant risk as it involves a high degree of estimation uncertainty.

Significant risk	■
Normal risk	
Fraud risk	
Assess design & implementation of controls to mitigate	■
Significant Management estimates & judgements	■
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

Local authorities are required to ensure that the carrying value of land, buildings and dwellings is not materially different to the current value (operational assets) or fair value (surplus assets, assets held for sale and investment properties) at the balance sheet date. There is a risk over the valuation of these assets due to the high degree of estimation uncertainty and where updated valuations have not been provided for a class of assets at the year-end.

RICS has issued guidance to valuers regarding material uncertainties in valuations due to prevailing market conditions. A RICS Material Valuation Uncertainty Leaders Forum meets weekly and regularly provides updates to practitioners.

The Council's valuers are engaged to provide valuations at 1 December and to refresh these valuations to 31 March. There is a significant risk that the valuers will not be able to provide valuations without reporting a material uncertainty over certain classes of assets.

Planned audit approach

Our audit procedures will include the following:

- Reviewing the instructions provided to the valuer and the valuer's skills and expertise in order to determine if we can rely on the management expert;
- Confirming that the basis of valuation for assets valued in year is appropriate based on their usage;
- Reviewing accuracy and completeness of information provided to the valuer, such as rental agreements and sizes;
- Reviewing assumptions used by the valuer in light of the prevailing market conditions to support the valuations including any material uncertainty for classes of assets ~~and movements against relevant indices for similar classes of assets~~;
- Following up valuation movements that appear unusual or outside of our expectations; and
- Confirming that assets not specifically valued in the year have been assessed to ensure their reported values remain materially correct.

Potential modification of the audit report

We will refer to any material uncertainty over valuations of classes of assets in our audit report where the valuer has referred to a material uncertainty over those valuations.

ALLOWANCES FOR NON-COLLECTION OF RECEIVABLES AND DEBT

There is a risk over the valuation of the impairment allowance for the non-collection of arrears and debt.

Significant risk	■
~~Normal risk~~	
Fraud risk	
Assess design & implementation of controls to mitigate	
Significant Management estimates & judgements	■
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

The Council recognises an allowance for the non-collection of receivables (arrears and debt), primarily in respect of council tax, NDR, housing benefit overpayments, housing rents and parking charges. The Council assesses each type of receivable separately in determining how much to allow for non-collection. There is a risk over the valuation of this allowance if incorrect assumptions or source data are used, or an inappropriate methodology is applied.

There is an increased risk of customer default over collection of receivables where the losses are measured at either the Incurred Credit Loss model for statutory debt (eg council tax and NDR) or Expected Credit Loss (contract receivables). For some receivables, the Council may have suspended recovery action or offered deferred payment terms, and some customers that may be taking advantage of these arrangements may be in financial difficulty.

Estimating potential losses from defaults on amounts due will be subject to a greater degree of estimation than in previous years, historical collection rates may offer only some indication of potential future losses and assigning key economic metrics that may reflect patterns of historic default rates may be imperfect in the current conditions.

Planned audit approach

Our audit procedures will include the following:

- Reviewing the provision model for significant income streams and receivables / debt balances to assess whether it appropriately reflects potential default losses in light of current conditions using historical collection rates, an assessment of potential defaults for customers making use of deferral arrangements and aging of debt, and future losses and assessing the sensitivities to the impairment calculation and assumptions used by management; and
- Reviewing business plans to support recoverability of amounts due as receivables or loans from subsidiaries and other group entities.

GOING CONCERN

Current conditions and interruption of normal cash flows may result in a local authority having insufficient cash to meet liabilities as the fall due.

Significant risk	■
Normal risk	
Fraud risk	
Assess design & implementation of controls to mitigate	
Significant Management estimates & judgements	
Controls testing approach	
Substantive testing approach	■
Risk highlighted by Council	

Risk detail

It is management's responsibility to make an assessment of an entity's ability to continue as a going concern and provide appropriate disclosures relating to how that assessment was performed and its results.

The assessment of going concern under the effects of the coronavirus outbreak will need to incorporate unprecedented shocks to forecasts. The increased demand on services, decline in income from services, deferrals of normal payment terms or impairment of debt, decreases in asset values and supply chain disruptions may be dissimilar to any previously encountered 'real world' scenario, making forecasting the precise results difficult.

The effects of the coronavirus are likely to affect the level of uncertainty that may exist in an assertion that the entity will be able to continue as a going concern. Regardless of the result of management's assessment, many entities will need to disclose key judgments and estimates it used to arrive at this conclusion.

Key areas in a going concern assessment may include: sources of assumed liquidity and cash flows, forecasts of future revenue or additional expenditure, and support from government.

Planned audit approach

Our audit procedures will include the following:

- Review management's assessment of going concern, including sensitivities of the assumptions and impact on cash flows and available reserves; and
- Understanding how management would address a shortfall in cash available to meet liabilities as they fall due.

Potential modification of the audit report

If a material uncertainty does exist, this should be disclosed in terms that are as specific to the Council as users of the financial statements will wish to know how and when the uncertainty might crystallise and its effects. This will need to be referenced in the relevant disclosure and will result in a material uncertainty reference in the audit report (albeit the audit opinion is not qualified).

FOR MORE INFORMATION:

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