LONDON FIRE BRIGADE

# External Audit Plan 2019/20 Report

| Report to | Date |
|---|---|
| Corporate Services DB<br>Commissioners Board | 17 March 2020<br>25 March 2020 |

| Report by | Report number |
|---|---|
| Assistant Director Finance | LFC-0329 |

Protective marking: **NOT PROTECTIVELY MARKED**
Publication status: Published in full


## Summary
The purpose of this report is to present the draft external audit plan 2019/20. The plan, attached at Appendix 1, summarises the external auditor's assessment of the key risks and outlines their planned audit strategy in response to those risks. The report also sets out the fees for the audit programme of works, to meet the requirements of the Local Audit and Accountability Act 2014 and other auditing standards and professional requirements.


## Recommended decision
That the London Fire Commissioner notes the External Audit Plan 2019/20.

## Background
1. This report presents the external audit plan for the 2019/20 Statement of Accounts and Value for Money audits, as prepared by the LFC's external auditors Ernst and Young LLP. The report summarises their assessment of key risks, provides details of their approach to the audit, the processes they will employ in addressing those risks and in determining their audit opinion on the LFC's accounts, and their conclusion on the LFC's arrangements for securing economy, efficiency and effectiveness.

2. The external auditors will also review and report to the National Audit Office on the LFC's Whole of Government Accounts (WGA) return. The audit plan also details the external audit scale fees for the 2019/20 audit.

## External Audit assessment of risks facing the LFC
3. The table below sets out the key financial statement risks facing the London Fire Commissioner that the external auditor has identified in the audit plan. Full details of the risks and proposed audit response are set out in sections 2 and 3 of the external audit plan at Appendix 1.

| **Key Risks** |
|---|

**Misstatement due to fraud or effort**
As identified in ISA 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 would otherwise appear to be operating effectively.

**Risk of fraud in revenue recognition**
Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition.

The material revenue income stream relates to the Metropolitan Fire Brigade (MFB) Act. During the 2018/19 audit issues were identified around the completeness of the list of insurers used to determine MFB Act income.

**Valuation of the pension fund**
The LFC's current pension fund net deficit is a material and judgemental item. Accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions this is considered a significant risk.

**Property valuations**
Auditing standards (ISA 620) require auditors to gain particular assurances when an expert has been engaged and where this influences material figures in the financial statements.

The valuation of fire stations continues to development to become fully compliant with accounting standards.

A full revaluation of all fire stations has been undertaken for 2019/20, and this further increases the risk of material misstatement.

**Going Concern Compliance with ISA 570**
This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the LFC will be the audit of the 2020/21 financial statements.

The revised standard increases the work auditors are required to perform when assessing whether the LFC is a going concern.

**IFRS16 – leases**
IFRS 16 Leases was issued by the IASB in 2016. Its main impact is to remove (for lessees) the traditional distinction between finance leases and operating leases.

IFRS 16 requires all substantial leases to be accounted for as an asset on the balance sheet.

**Findings of external regulators**
The Grenfell Tower Inquiry and HMICFRS reports identified a number of areas requiring improvement. Although notable actions have been undertaken by the Commissioner in response, the arrangements commented on by HMICFRS have been in place for the majority of the 2019/20 financial year.

The auditor's assessment of the adequacy of VFM arrangements looks at whether or not those arrangements were in place throughout the year of audit. Given the timing of the findings and despite

| |
|---|
| actions already in place by the organisation to address those findings, the auditors will need to consider the impact of this on the VFM conclusion. |
| **Financial resilience**<br>The HMICFRS report included a review of the efficiency of the organisation. Both areas reviewed were rated as 'requires improvement'. These relate to making the best use of resources, as well as the affordability of the fire and rescue service.<br><br>The report identified that there is a potential overreliance on reserves and on additional funding from the Mayor to bridge funding gaps.<br><br>There is a risk that the costs of the Transformation Delivery Plan increase beyond initial estimates, increasing the existing four year budget gap.<br><br>There is also uncertainty around the additional costs associated with the firefighters pension fund. |

4. The risks have been reviewed and updated from the previous year by the external auditors. Some of the risks presented cover the same areas as last year, on ISA 240 on fraud and recognition of income, the pension fund and ISA 620 on asset valuations, with the latter two continuing to pose a significant risk. New risks have been added on ISA 570 on going concern, and IFRS 16 on leases, as follows.

   a) **Going concern compliance with ISA 570** - this addresses a new concern in response to well publicised corporate failures. This requires additional work to determine an entity should be treated as a going concern, although it is not considered appropriate for local authority accounts to be prepared on anything other than a going concern basis.

   b) **IFRS 16 leases** - the removes the distinction between finance and operating leases, and with all leases now treated as assets on the balance sheet. For this first year it is about preparation for full implementation from 1 April 2020.

   c) **Risk of error in expenditure accruals** - has been added as a new risk due to history of errors in this area.

5. The audit plan also now includes two specific risks on the Value for Money opinion, as follows.

   d) **Findings from external regulators** - to consider the impact of the reports from the Grenfell Tower inquiry and the HMICFRS inspections reports, and the recommendations made in those reports.

   e) **Financial resilience** – to consider the impact of the HMICFRS findings, in particular in relation to efficiency, with the requires improvement relating on best use of resources and making the service affordable now and in the future, given the budget gap set out in the Medium Term Forecast.

**Audit Team Changes**

6. For the 2019/20 the audit team will continue to be led by Janet Dawson EY Partner and Eli Johns Senior Manager. The main audit team will be led by Scott Green, Assistant Manager, who was part of the audit team last year, and Giulia Carmignani as the new Lead Senior .

**Audit Timetable**

7. As the audit timetable, at section 7 of Appendix 1, shows, the audit is to be completed to allow the Statement of Accounts to be published by 31 July.

**Audit Fees and Audit arrangements for future years**

8. The LFC's external audit contract is managed under arrangements agreed with Public Sector Audit Appointments Ltd (PSAA). Following the most recent contract renewals by PSAA Ernst and Young were appointed as the LFC's external auditor for five years from 2018/19. As part of the contractual arrangements, PSAA sets the scale fees for all audits and the scale fee for the LFC for 2019/20 is £51,961, which is the same level as 2018/19. The audit fee in 2018/19 was subject to additional charges relating work on MFB Act income, asset valuations and pensions. The external auditors are proposing an additional fee for the 2019/20 audit of £47,200 to bring the total fee to £99,161. The proposed fees, at £99,161, are subject to the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- The auditors accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the LFC; and
- The LFC has an effective control environment.

9. The current working arrangements to address the coronavirus add additional challenges and risks to the accounts preparation and audit processes. Officers are working to address these, and will maintain dialogue with the auditors as the systems develop.

10. The audit fees are summarised in the table below.

| | **Planned fee 2019/20 £** | **Scale Fee 2019/20 £** | **Final Fee 2018/19 £** |
|---|---|---|---|
| Scale Fee | 51,961 | 51,961 | 51,961 |
| Changes in work required to address professional and regulatory requirements (2019/20 impact), and scope associated with risk | 47,200 | N/A | 13,274* |
| Total Audit Fee | 99,161 | 51,961 | 65,235 |

* The 18/19 Code work includes an additional fee of £13,274, which relates to additional work reviewing asset valuations, Metropolitan Fire Brigade Act income and additional work in relation to pensions – particularly the impact of the McCloud/Sargent ruling. We have agreed the variation with officers, but are awaiting approval from PSAA.

11. The main element of the proposed additional fees, totalling £47.2k, relates to non LFB specific issues, with £24.2k relating audit requirements changes EY state are not covered by the PSAA contracts, as well as a small amount on technology improvements. There is however £15k of the proposed fee that is LFB specific, with £7k relating to additional work on the Value for Money opinion following the Grenfell and HMICFRS reports, £5k for work on pensions and MFB Act income, and £3k relating to preparations for the new accounting standard on leases. The detail on the proposed additional fee is to be discussed in a meeting with EY on 23 March, to be attended by the Director of Corporate Services and the Assistant Director – Finance, and a verbal update on this will be provided at the CB meeting

**Finance comments**

12. This report is prepared by the Assistant Director - Finance and as such Finance comments have been incorporated into the report.

**Workforce comments**

13. There are no direct workforce implications associated with the contents of this report requiring staff side consultation.

**Legal comments**

14. The London Fire Commissioner is required to comply with the provisions of the Local Audit and Accountability Act 2014 ("2014 Act") and subsidiary legislation and guidance by virtue of Schedule 2 of the 2014 Act.

15. The 2014 Act requires that the LFEPA and LFC's accounts for a financial year must be audited both:

    a) in accordance with the 2014 Act and provision made under it, and
    b) by an auditor (a "local auditor") appointed in accordance with this Act or provision made under it.

16. Ernst and Young are the appointed auditor and this report provides an update on current and future external audit arrangements.

**Sustainability implications**

17. There are no direct sustainability implications arising from this report.

**Equalities Implications**

18. The London Fire Commissioner and decision takers are required to have due regard to the Public Sector Equality Duty (s149 of the Equality Act 2010) when exercising our functions and taking decisions.

19. It is important to note that consideration of the Public Sector Equality Duty is not a one-off task. The duty must be fulfilled before taking a decision, at the time of taking a decision, and after the decision has been taken.

20. The protected characteristics are: Age, Disability, Gender reassignment, Pregnancy and maternity, Marriage and civil partnership (but only in respect of the requirements to have due regard to the need to eliminate discrimination), Race (ethnic or national origins, colour or nationality), Religion or belief (including lack of belief), Sex, and Sexual orientation.

21. The Public Sector Equality Duty requires us, in the exercise of all our functions (i.e. everything we do), to have due regard to the need to:

    (a) Eliminate discrimination, harassment and victimisation and other prohibited conduct.

    (b) Advance equality of opportunity between people who share a relevant protected characteristic and persons who do not share it.

    (c) Foster good relations between people who share a relevant protected characteristic and persons who do not share it.

22. Having due regard to the need to advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to:

    (a) remove or minimise disadvantages suffered by persons who share a relevant protected characteristic where those disadvantages are connected to that characteristic;

    (b) take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of persons who do not share it;

    (c) encourage persons who share a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

23. The steps involved in meeting the needs of disabled persons that are different from the needs of persons who are not disabled include, in particular, steps to take account of disabled persons' disabilities.

24. Having due regard to the need to foster good relations between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to

    (a) tackle prejudice, and

    (b) promote understanding.

25. An Equality Impact Assessment (EIA) has not been undertaken.

26. An EIA was not required because there are no significant equality implications anticipated to arise directly from this report.

**List of Appendices**

| Appendix | Title | Protective Marking |
|---|---|---|
| 1. | London Fire Commissioner - 2019/20 Audit Planning Report | None |

# London Fire Commissioner

## Audit planning report

Year ended 31 March 2020

March 2020



Building a better working world

Private and Confidential

March 2020

London Fire Commissioner
169 Union Street
London
SE1 0LL

Dear Fire Commissioner

Audit planning report

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 those charged with governance with a basis to review our proposed audit approach and scope for the 2019/20 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 London Fire Commissioner, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of those charged with governance 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 25 March 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

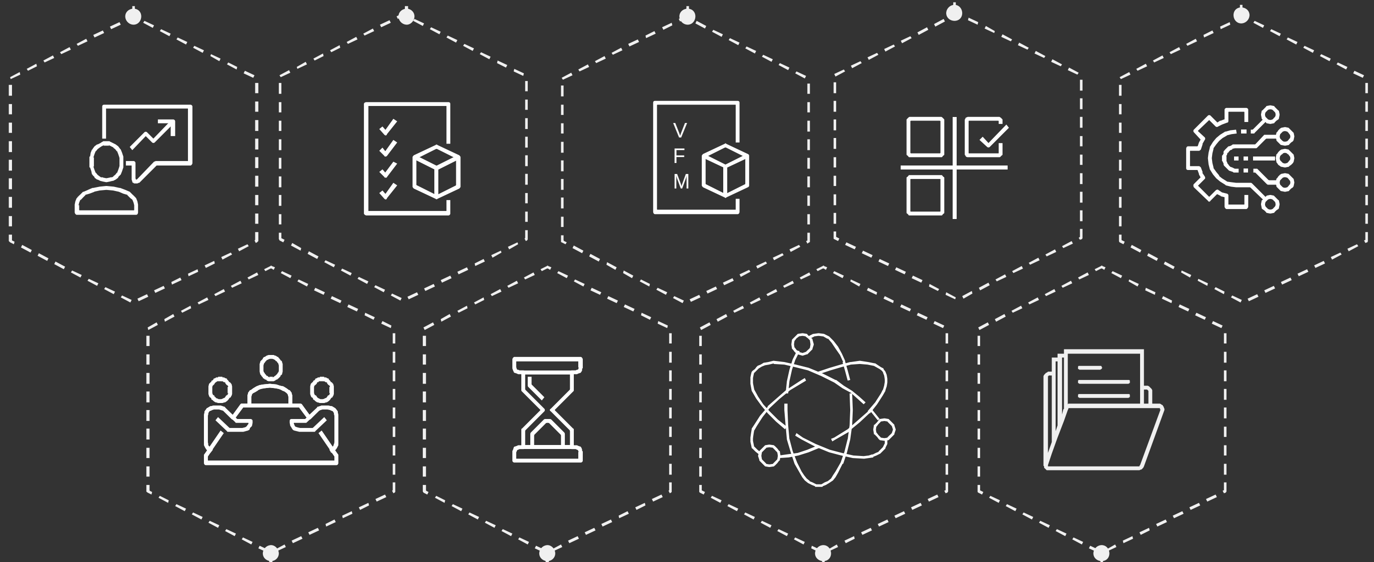
Janet Dawson

Partner

For and on behalf of Ernst & Young LLP

# Contents








Page 211

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.psaa.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 Commissioner and management of London Fire Commissioner in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Commissioner and management of London Fire Commissioner 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 Commissioner and management of London Fire Commissioner 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 2019/20 audit strategy

# Overview of our 2019/20 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the London Fire Commissioner 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 |
|---|---|---|---|
| Misstatements due to fraud or error | Fraud risk | No change in risk or focus | As identified in ISA 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 would otherwise appear to be operating effectively. In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below. |
| Risk of fraud in revenue recognition – MFB Act Income | Fraud risk | No change in risk of focus | Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition.<br><br>We have assessed the income and expenditure streams and concluded that this risk relates to MFB Act Income. There are no other significant income streams that are not related to grant income. |
| Risk of error in the valuation of the net pension liability | Significant risk | No change in risk of focus | The London Fire Commissioner's current pension fund net deficit is a material and judgemental item. Small changes in assumptions when valuing these assets and liabilities can have a material impact on the financial statements. The Code requires the London Fire Commissioner to disclose this liability on the Balance Sheet.<br><br>We have reflected on the significance of the liability to the London Fire Commissioner's balance sheet, as well as (in the case of the Local Government Pension Scheme) the difficulty in valuing some of the pension fund assets, and classified this as a significant risk. Furthermore, it was the subject of an error in the prior year. |
| Risk of error in property valuations | Significant risk | No change in risk or focus | Auditing standards (ISA 620) require us to gain particular assurances when an expert has been engaged and where this influences material figures in the financial statements. The London Fire Commissioner engages a professional valuer to provide it with asset valuations. The bulk of its estate relates to fire stations. These are specialised assets, and therefore a depreciated replacement cost methodology should be used to determine the existing use value. In previous financial years the methodology employed by the valuer in determining these valuations departed from the Red Book and the Code of Practice on Local Authority Accounting (the Code). In 2019/20 improvements continue to be made in bringing the methodology to be in line with the red book/ code requirements. However, the methodology continues to be developed each year which increases the risk of material misstatement. Furthermore, for 2019/20 a full revaluation has been undertaken of all fire stations, as opposed to a sample. This further increases the risk of material misstatement. |

# Overview of our 2019/20 audit strategy (cont.)

## Materiality

| Planning materiality | Materiality has been set at £10 million, which represents 1.8% of the prior year gross expenditure on provision of services. |
|---|---|
| **£10m** | |
| Performance materiality | Performance materiality has been set at £7.5 million, which represents 75% of materiality. |
| **£7.5m** | |
| Audit differences | We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, and firefighters' pension fund financial statements) greater than £0.5m. Other misstatements identified will be communicated to the extent that they merit the attention of the London Fire Commissioner.<br><br>Please see the Audit Materiality section of this report (section 04) for further information and definitions, as well as details of materiality set for the firefighters' pension fund account. |
| **£0.5m** | |

# Overview of our 2019/20 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 London Fire Commissioner give a true and fair view of the financial position as at 31 March 2020 and of the income and expenditure for the year then ended; and

- Our conclusion on the London Fire Commissioner'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 London Fire Commissioner'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 London Fire Commissioner.

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 15 in recent years as well as the expansion of factors impacting the value for money conclusion. We have included an estimate into the fee page in Appendix A on page 36, and we will discuss these with management as to the impact on the scale fee.

# 02 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. We will notify you of any changes to our assessment of risks as they occur.

| | What is the risk? | What will we do? |
|---|---|---|
| Misstatements due to fraud or error* | As identified in ISA 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 would otherwise appear to be operating effectively. | We will respond to the risk by:<br>• Making inquiries of management about risks of fraud and the controls put in place to address those risks;<br>• Understanding the oversight given by the London Fire Commissioner, in his role as those charged with governance, of management's processes for safeguarding against fraud; and<br>• Consideration of the effectiveness of management's controls designed to address the risk of fraud.<br>We will also perform mandatory procedures regardless of specifically identified fraud risks, including:<br>• Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;<br>• Assessing accounting estimates for evidence of management bias and<br>• Evaluating the business rationale for significant unusual transactions.<br>In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below. |

Page 217

# Our response to significant risks (continued)

**Risk of fraud in revenue recognition – MFB Act Income***



### What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition.

The only material revenue income stream which is not grant related, and which we have therefore assessed as at risk of manipulation, is income relating to the Metropolitan Fire Brigade (MFB) Act. MFB Act income recognised in each financial year is a combination of that levied in the previous and current calendar years. Recognition is therefore complex and susceptible to manipulation.

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. At planning stage, we have concluded that in the case of the London Fire Commissioner, this is not a material, likely risk.

During the 2018/19 audit issues were identified around the completeness of the list of insurers used to determine MFB Act income. This resulted in a control finding as communicated in the 2018/19 Audit Results Report. We have determined the risk is still relevant for 2019/20.

### What will we do?

Our approach will focus on the following areas in relation to MFB Act income :

- Review and test MFB revenue recognition policy and ensure that it is consistent with the Act and with accounting standards;
- Test a sample of MFB revenue transactions to ensure that they have been recognised at the appropriate amount and in the correct accounting period, including the correct receipts in advance split; and
- Test unpaid MFB invoices to identify indicators that the debt should be impaired or written off; and
- Understanding variances in income recognised compared to budget and prior years; and
- For a sample of insurers, test that they have been correctly recorded in the entity's database and that any associated levy's have been correctly raised.

# Our response to significant risks (continued)

**Risk of error in the valuation of the net pension liability**



| What is the risk? | What will we do? |
|---|---|
| The London Fire Commissioner's current pension fund net deficit is a material and judgemental item. Small changes in assumptions when valuing these assets and liabilities can have a material impact on the financial statements. The Code requires the London Fire Commissioner to disclose this liability on the Balance Sheet.<br><br>The information disclosed is based on the IAS 19 report issued to the London Fire Commissioner by the actuary. Accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions we consider this to be a significant risk. | We will respond to this risk by:<br><br>• Liaising with the auditors of the London Pensions Fund Authority, the LGPS administering authority, to obtain assurances over the information supplied to the actuary in relation to the London Fire Commissioner;<br><br>• Assessing the conclusions drawn on the work of the actuaries, Barnett Waddingham and Hymans Robertson, by the Consulting Actuary, PWC, who are commissioned by the National Audit Office, including the use of our own pensions specialists; and<br><br>• Reviewing and testing the accounting entries and disclosures made in relation to IAS19.<br><br>• Monitor ongoing developments, such as the determination due in June 2020, and emerging guidance surrounding the McCloud ruling, ensuring the pensions disclosures are compliant. |

# Our response to significant risks (continued)

| Risk of error in property valuations | What is the risk? | What will we do? |
|---|---|---|
| | Auditing standards (ISA 620) require us to gain particular assurances when an expert has been engaged and where this influences material figures in the financial statements. The London Fire Commissioner engages a professional valuer to provide it with asset valuations. The bulk of its estate relates to fire stations. These are specialised assets, and therefore a depreciated replacement cost methodology should be used to determine the existing use value. In previous financial years the methodology employed by the valuer in determining these valuations departed from the Red Book and the Code of Practice on Local Authority Accounting (the Code). In 2019/20 improvements continue to be made in bringing the methodology to be in line with the red book/ code requirements. However, the methodology continues to be developed each year which increases the risk of material misstatement. Furthermore, for 2019/20 a full revaluation has been undertaken of all fire stations, as opposed to a sample. This further increases the risk of material misstatement. | We will respond to this risk by:<br>• Reviewing the valuation instructions provided to the valuer against the requirements of the Code of Accounting Practice for Local Government;<br>• Engaging our internal expert to assess the appropriateness of the methodology applied by the valuer in valuing specialised assets;<br>• Confirming that the information provided by the valuer as the management's expert has been appropriately reflected in the financial statements; and<br>• Reviewing and testing the accounting entries and disclosures made within the financial statements. |

# 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? | What will we do? |
|---|---|
| Going Concern Compliance with ISA 570<br><br>This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.<br><br>The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the London Fire Commissioner will be the audit of the 2020/21 financial statements. The revised standard increases the work we are required to perform when assessing whether the London Fire Commissioner is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards; and we have therefore judged it appropriate to bring this to the attention of the Audit Committee.<br><br>The CIPFA Guidance Notes for Practitioners 2019/20 accounts states 'The concept of a going concern assumes that an authority's functions and services will continue in operational existence for the foreseeable future. The provisions in the Code in respect of going concern reporting requirements reflect the economic and statutory environment in which local authorities operate. These provisions confirm that, as authorities cannot be created or dissolved without statutory prescription, they must prepare their financial statements on a going concern basis of accounting.'<br><br>'If an authority were in financial difficulty, the prospects are thus that alternative arrangements might be made by central government either for the continuation of the services it provides or for assistance with the recovery of a deficit over more than one financial year. As a result of this, it would not therefore be appropriate for local authority financial statements to be provided on anything other than a going concern basis.' | The revised standard requires:<br><br>• auditor's challenge of management's identification of events or conditions impacting going concern, more specific requirements to test management's resulting assessment of going concern, an evaluation of the supporting evidence obtained which includes consideration of the risk of management bias;<br>• greater work for us to challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence we obtained and evaluate the risk of management bias. Our challenge will be made based on our knowledge of the London Fire Commissioner obtained through our audit, which will include additional specific risk assessment considerations which go beyond the current requirements;<br>• improved transparency with a new reporting requirement for public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work we have done in this respect.<br>• a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when we draw our conclusions on going concern; and<br>• necessary consideration regarding the appropriateness of financial statement disclosures around going concern.<br><br>The revised standard extends requirements to report to regulators where we have concerns about going concern.<br><br>We will discuss the detailed implications of the new standard with finance staff during 2019/20 ahead of its application for 2020/21. |

# Other areas of audit focus (continued)

## What is the risk/area of focus?

IFRS16 – leases

IFRS 16 Leases was issued by the IASB in 2016. Its main impact is to remove (for lessees) the traditional distinction between finance leases and operating leases. Finance leases have effectively been accounted for as acquisitions (with the asset on the balance sheet, together with a liability to pay for the asset acquired). In contrast, operating leases have been treated as “pay as you go” arrangements, with rentals expensed in the year they are paid. IFRS 16 requires all substantial leases to be accounted for using the acquisition approach, recognising the rights acquired to use an asset.

Implementation of IFRS 16 will be included in the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) for 2020/21. This Code has yet to published, but in July 2019 CIPFA/LASAAC issued ‘IFRS 16 leases and early guide for practitioners’.

This early guidance provides comprehensive coverage of the requirements of the forthcoming provisions, including:

- the identification of leases
- the recognition of right-of-use assets and liabilities and their subsequent measurement
- treatment of gains and losses
- derecognition and presentation and disclosure in the financial statements,
- the management of leases within the Prudential Framework.

The guidance also covers the transitional arrangements for moving to these new requirements, such as:

- the recognition of right-of-use assets and liabilities for leases previously accounted for as operating leases by lessees
- the mechanics of making the transition in the 2020/21 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).

## What will we do?

IFRS 16 – leases introduces a number of significant changes which go beyond accounting technicalities. For example, the changes have the potential to impact on procurement processes as more information becomes available on the real cost of leases.

The key accounting impact is that assets and liabilities in relation to significant lease arrangements previously accounted for as operating leases will need to be recognised on the balance sheet.

Although the new standard will not be included in the CIPFA Code of Practice until 2020/21, work will be necessary to secure information required to enable authorities to fully assess their leasing position and ensure compliance with the standard from 1 April 2020.

In particular, full compliance with the revised standard for 2020/21 is likely to require a detailed review of existing lease and other contract documentation prior to 1 April 2020 in order to identify:

- all leases which need to be accounted for
- the costs and lease term which apply to the lease
- the value of the asset and liability to be recognised as at 1 April 2020 where a lease has previously been accounted for as an operating lease.

We will discuss progress made in preparing for the implementation of IFRS 16 – leases with the finance team over the course of our 2019/20 audit.

# 03 Value for Money Risks

# Value for Money

## Background

We are required to consider whether the London Fire Commissioner 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 2019/20 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.

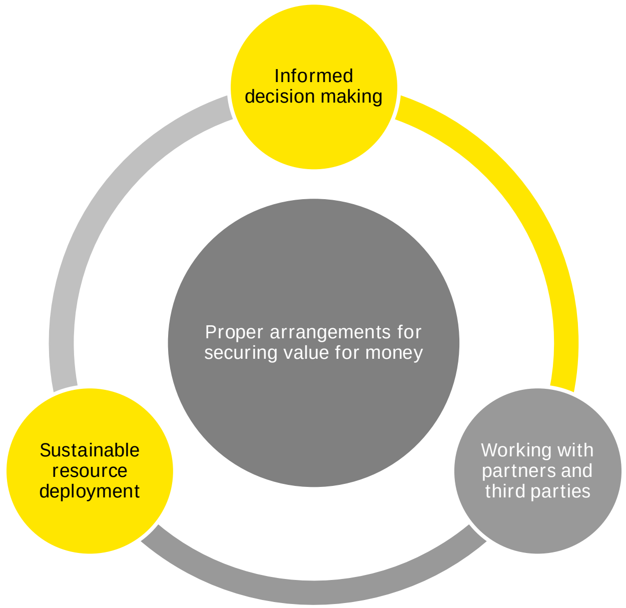
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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.

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 risks noted on the following pages which we view as relevant to our value for money conclusion.



# Value for Money Risks

| What is the significant value for money (VFM) risk? | What arrangements does the risk affect? | What will we do? |
|---|---|---|
| Findings of external regulators and the Commissioner’s response<br><br>The Grenfell Tower Inquiry October 2019 - phase 1 report was released during the year, in which multiple findings and recommendations were raised in respect of the Commissioner’s planning and preparation arrangements in place before the Grenfell incident. Recommendations were also made in relation to the policies and procedures in place within the organisation.<br><br>Subsequently, the December 2019 HMICFRS Effectiveness, Efficiency and People report was also released during the year, following an inspection period of May to July 2019.<br><br>This report identified a number of areas requiring improvement. Most notably this included; staff training, protecting the public through fire regulation and responding to fires and other emergencies. Although notable actions have been undertaken by the Commissioner in response, the arrangements commented on by HMICFRS have been in place for the majority of the 2019/20 financial year.<br><br>The Commissioner has also identified that the internal information systems, including KPIs, corporate and strategic risks in place during the majority of 2019/20 had not been adequately focused on the areas identified by those reports.<br><br>Our assessment of the adequacy of VFM arrangements looks at whether or not those arrangements were in place throughout the year of audit. Given the timing of the findings and despite actions already in place by the organisation to address those findings, we anticipate that this will result in qualification of our VFM conclusion. | Take informed decisions | Our approach will focus on:<br><br>• Consideration of the scope and timing of the Transformation Delivery Plan, setting out the Commissioner’s response to the recommendations in both the Phase 1 Grenfell Report and HMICFRS inspection report<br><br>• Understanding the key governance decisions undertaken by the organisation during 2019/20 concerning the report findings and recommendations<br><br>• Assess the appropriateness of the planned actions against the recommendations raised in the reports from external regulators.<br><br>• Assessment of the actions taken to date to address the findings, including:<br>o Inspection of internal reporting and enquiries of key operational staff members<br>o Understanding how the organisation has amended internal information systems to more accurately reflect the key areas of focus<br><br>Given the nature, pervasiveness and timing of the issues raised from external regulators, we will need to consider qualification of the VFM conclusion and will consult internally on the nature of the qualification. |

# Value for Money Risks

| What is the significant value for money (VFM) risk? | What arrangements does the risk affect? | What will we do? |
|---|---|---|
| Financial resilience and funding arrangements<br><br>The HMICFRS December 2019 report included a review of the efficiency of the organisation. Both areas reviewed were rated as ‘requires improvement’. These relate to making the best use of resources, as well as the affordability of the fire and rescue service.<br><br>The report identified that there is a potential overreliance on reserves and on additional funding from the Mayor to bridge funding gaps. Current forecasts suggest this is unsustainable and that by 2023 reserves will have been almost fully utilised.<br><br>There is a risk that the costs of the Transformation Delivery plan increase beyond initial estimates, increasing the existing four year budget gap, identified in the 2020/21 budget submission. There is also uncertainty around the additional costs associated with the firefighters pension fund. | Sustainable resource deployment | Our approach will focus on:<br><br>• Understanding the development of the transformation plan, and in particular how it has been designed to address the challenge over the organisation’s service efficiency;<br><br>• Understanding how the organisation is engaging with the Mayor, to communicate and mitigate risks arising from changes to costs;<br><br>• Reviewing the Medium Term Financial plan produced by the organisation, understanding the assumptions used and the risks associated with those assumptions, and assessing whether forecast and known changes are appropriately reflected within the plan. |

# 04 Audit materiality

# Materiality

## Materiality

For planning purposes, materiality for 2019/20 has been set at £10m. This represents 1.8% of the London Fire Commissioner's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. As a provider of public services, an activity-based measure focused on expenditure is an appropriate basis. In setting the level of materiality we have considered the level of reserves, the stable sources of funding, and the London Fire Commissioner's history of meeting its financial targets (typically with a small underspend). We have provided supplemental information about audit materiality in Appendix D.



Gross expenditure on provision of services
**£555m**

Planning materiality
**£10m**

Performance materiality
**£7.5m**

Audit differences
**£0.5m**

We request that the London Fire Commissioner confirm his 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 £10m which represents 75% of planning materiality. In determining this level we have considered our expectation of the level of errors based a range of factors including the control environment and the quantum and nature of misstatements in the prior year. We have concluded that the control environment is strong.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, and firefighters' pension fund financial statements 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 Commissioner, or are important from a qualitative perspective.

Specific materiality – We have set a materiality of £2.9 million for the firefighters' pension fund financial statements 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.

# 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 London Fire Commissioner'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.

Page 230

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 London Fire Commissioner 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:

- Assessing the key internal controls in place and testing the operation of these controls;
- Review of the work of Internal Audit;
- Reliance on the work of experts in relation to areas such as pensions, private finance initiative and property valuations; and
- Substantive tests of detail of transactions and amounts.

For 2019/20 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 Committee.

Internal audit:
We will regularly meet with the Internal Audit team, 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

## Our Audit Process and Strategy (continued)

### Earlier deadline for production of the financial statements

The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July.

These changes provide risks for both the preparers and the auditors of the financial statements:

- London Fire Commissioner now has less time to prepare the financial statements and supporting working papers. Additionally, during 2019/20 the organisation has experienced changes in the composition of the finance team and staffing of key members. There is the potential for this to negatively impact on the timely delivery of documentation required for audit purposes.
- As your auditor, we have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within same compressed timetable. Slippage at one client could potentially put delivery of others at risk.

To mitigate this risk we will require:

- good quality draft financial statements and supporting working papers by the agreed deadline;
- appropriate staff to be available throughout the agreed audit period; and
- complete and prompt responses to audit questions.

If you are unable to meet key dates within our agreed timetable, we will notify you of the impact on the timing of your audit, which may be that we postpone your audit until later in the summer and redeploy the team to other work to meet deadlines elsewhere.

Where additional work is required to complete your audit, due to additional risks being identified, additional work being required as a result of scope changes, or poor audit evidence, we will notify you of the impact on the fee and the timing of the audit. Such circumstances may result in a delay to your audit while we complete other work elsewhere.

To support London Fire Commissioner we will:

- Work with the finance team to engage early to facilitate early substantive testing where appropriate.
- Provide an early review on the streamlining of the Statement of Accounts where non-material disclosure notes are removed.
- Work with the organisation to continue to develop the use of EY Client Portal, this will:
  - Streamline our audit requests through a reduction of emails and improved means of communication;
  - Provide on –demand visibility into the status of audit requests and the overall audit status;
  - Reduce risk of duplicate requests; and
  - Provide better security of sensitive data.
- Agree the team and timing of each element of our work with you.
- Agree the supporting working papers that we require to complete our audit.

# 06 Audit team

# Audit team

Audit team structure:

- Janet Dawson
  Lead Audit Partner
- Eli Johns
  Senior Manager
- Scott Green
  Assistant Manager
- Giulia Carmignani
  Lead Senior

- EY Pensions (Pensions Specialist)
- Mark Gerold
  Director – EY Real Estate (Valuations Specialist)
- Peter Codd
  Manager – EY Real Estate (Valuations Specialist

Page 234

# 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 | EY Real Estate Specialists<br>Management Specialist – Dron & Wright |
| Pensions disclosure | EY Pensions Specialists<br>Management Specialist - Barnett Waddingham – Local Government Pension Scheme<br>Management Specialist – Government Actuary's Department – Firefighters Pension Scheme |

Page 235

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 London Fire Commissioner'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
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

# 07 Audit timeline

# Audit timeline

## 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 2019/20

From time to time matters may arise that require immediate communication with the London Fire Commissioner and we will discuss them with you as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Page 237

| Audit phase | Timetable | Meeting timetable | Deliverables |
|---|---|---|---|
| Planning:<br>Risk assessment and setting of scopes. | January | | |
| Walkthrough of key systems and processes<br>Interim Audit Testing | February | | |
| | March | Corporate Services Directorate Board<br>Commissioner's Board | Audit Planning Report |
| Year End Audit (Valuations) | April | | |
| | May | | |
| Year End Audit<br>Audit Completion Procedures | June | | |
| | July | Corporate Services Directorate Board<br>Commissioner's Board | Audit Results Report<br>Audit opinions and completion certificates |
| | August - October | | Annual Audit Letter |

# 08 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** |
| ▸ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;<br>▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;<br>▸ The overall assessment of threats and safeguards;<br>▸ Information about the general policies and process within EY to maintain objectivity and independence.<br>▸ 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] | ▸ 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;<br>▸ Details of non-audit services provided and the fees charged in relation thereto;<br>▸ 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;<br>▸ Written confirmation that all covered persons are independent;<br>▸ 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;<br>▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and<br>▸ An opportunity to discuss auditor independence issues. |

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 Janet Dawson, 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 entity. 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, 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 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, we have not agreed to undertake any non-audit services and therefore 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.

## 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 organisation. 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.

# New UK Independence Standards

The Financial Reporting Council (FRC) published the Revised Ethical Standard 2019 in December and it will apply to accounting periods starting on or after 15 March 2020. A key change in the new Ethical Standard will be a general prohibition on the provision of non-audit services by the auditor (and its network) which will apply to UK Public Interest Entities (PIEs). A narrow list of permitted services will continue to be allowed.

## Summary of key changes

- Extraterritorial application of the FRC Ethical Standard to UK PIE and its worldwide affiliates
- A general prohibition on the provision of non-audit services by the auditor (or its network) to a UK PIE, its UK parent and worldwide subsidiaries
- A narrow list of permitted services where closely related to the audit and/or required by law or regulation
- Absolute prohibition on the following relationships applicable to UK PIE and its affiliates including material significant investees/investors:
    - Tax advocacy services
    - Remuneration advisory services
    - Internal audit services
    - Secondment/loan staff arrangements
- An absolute prohibition on contingent fees.
- Requirement to meet the higher standard for business relationships i.e. business relationships between the audit firm and the audit client will only be permitted if it is inconsequential.
- Permitted services required by law or regulation will not be subject to the 70% fee cap.
- Grandfathering will apply for otherwise prohibited non-audit services that are open at 15 March 2020 such that the engagement may continue until completed in accordance with the original engagement terms.
- A requirement for the auditor to notify the Commissioner’s and Directorate Board if the audit fee might compromise perceived independence and the appropriate safeguards.
- A requirement to report to the audit committee details of any breaches of the Ethical Standard and any actions taken by the firm to address any threats to independence. A requirement for non-network component firm whose work is used in the group audit engagement to comply with the same independence standard as the group auditor. Our current understanding is that the requirement to follow UK independence rules is limited to the component firm issuing the audit report and not to its network. This is subject to clarification with the FRC.

## Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under FRC Revised Ethical Standard 2016 which will continue to apply until 31 March 2020 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 1 April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.

We do not provide any non-audit services which would be prohibited under the new standard.

# Other communications

| EY Transparency Report 2019 |
| --- |
| 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.<br>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 end 30 June 2019:<br>https://www.ey.com/en_uk/who-we-are/transparency-report-2019 |

# 09 Appendices

# Appendix A

## Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government.

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.

| | Scale fee 2019/20 | Final Fee 2018/19 |
|---|---|---|
| | £ | £ |
| Total Scale Fee | 51,961 | 51,961 |
| Changes in work required to address professional and regulatory requirements (2019/20 impact), and scope associated with risk | 47,200 | 13,274 (Note 1) |
| Total fee | 99,161 | 65,235 |

All fees exclude VAT

(1) The 18/19 Code work includes an additional fee of £13,274, which relates to additional work reviewing asset valuations, Metropolitan Fire Brigade Act income and additional work in relation to pensions – particularly the impact of the McCloud/Sargent ruling. We have agreed the variation with officers, but are awaiting approval from PSAA.

(2) For 2019/20, the scale fee will be impacted by a range of factors which will result in additional work, as set out on pages 5 to 18. We set out an estimate of the potential additional fee for this below. This provides an overall estimated additional fee of £47,200. The issues we have identified at the planning stage which will impact on the fee include:

- Additional risks – financial statements, including IFRS 16 £8,000
- Additional work that will be required to address the value for money risks identified. £7,000
- Requirements as a result of status as Major Local Audit: £6,000
- Costs associated with professional and regulatory compliance changes £16,000
- Technology and preparedness costs £2,200

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 entity; and
- The entity 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 entity 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.

# Fees

## Summary of key factors

1. Status of sector: Financial reporting and decision making in local public bodies has become increasingly complex in recent years, with accounting and reporting requirements resulting in complex and lengthy statements of accounts, which can be hard to understand for the user of the accounts.
2. Audit of estimates: There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.
3. Regulatory environment: Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice, are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.
4. Resourcing: As a result of the above, public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

   We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality. We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.

   To respond to these factors we have to:

   - Increase our sample sizes, seek higher levels of corroborative evidence and engage with our internal specialists on a wider array of matters;
   - Increase our investment in data analytics tools to allow us to test more transactions to a greater level of detail and enhance audit quality; and
   - Invest in our audit quality infrastructure, as a firm our compliance costs have doubled as a proportion of revenue over the past five years.

# Required communications with the London Fire Commissioner

We have detailed the communications that we must provide to the London Fire Commissioner.

| | | Our Reporting to you |
|---|---|---|
| **Required communications** | **What is reported?** | **When and where** |
| Terms of engagement | Confirmation by the London Fire Commissioner 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 – March 2020 |
| Significant findings from the audit | • Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures<br>• Significant difficulties, if any, encountered during the audit<br>• Significant matters, if any, arising from the audit that were discussed with management<br>• Written representations that we are seeking<br>• Expected modifications to the audit report<br>• Other matters if any, significant to the oversight of the financial reporting process | Audit results report – July 2020 |
| Going concern | Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:<br>• Whether the events or conditions constitute a material uncertainty<br>• Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements<br>• The adequacy of related disclosures in the financial statements | Audit results report – July 2020 |

# Appendix B

## Required communications with the Audit Committee (continued)

| | | Our Reporting to you |
|---|---|---|
| **Required communications** | **What is reported?** | **When and where** |
| Misstatements | • Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation<br>• The effect of uncorrected misstatements related to prior periods<br>• A request that any uncorrected misstatement be corrected<br>• Corrected misstatements that are significant<br>• Material misstatements corrected by management | Audit results report – July 2020 |
| Fraud | • Enquiries of the London Fire Commissioner to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity<br>• Any fraud that we have identified or information we have obtained that indicates that a fraud may exist<br>• A discussion of any other matters related to fraud | Audit results report – July 2020 |
| Related parties | • Significant matters arising during the audit in connection with the entity's related parties including, when applicable:<br>• Non-disclosure by management<br>• Inappropriate authorisation and approval of transactions<br>• Disagreement over disclosures<br>• Non-compliance with laws and regulations<br>• Difficulty in identifying the party that ultimately controls the entity | Audit results report – July 2020 |
| Independence | Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence<br>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:<br>• The principal threats<br>• Safeguards adopted and their effectiveness<br>• An overall assessment of threats and safeguards<br>• Information about the general policies and process within the firm to maintain objectivity and independence | Audit Planning report – March 2020<br>Audit results report – July 2020 |

# Appendix B

## Required communications with the Audit Committee (continued)

| | | Our Reporting to you |
|---|---|---|
| Required communications | What is reported? | When and where |
| External confirmations | • Management's refusal for us to request confirmations<br>• Inability to obtain relevant and reliable audit evidence from other procedures | Audit results report – July 2020 |
| Consideration of laws and regulations | • 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<br>• Enquiry of the London Fire Commissioner into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the London Fire Commissioner may be aware of | Audit results report – July 2020 |
| Internal controls | • Significant deficiencies in internal controls identified during the audit | Audit results report – July 2020 |
| Representations | Written representations we are requesting from management and/or those charged with governance | Audit results report – July 2020 |
| Material inconsistencies and misstatements | Material inconsistencies or misstatements of fact identified in other information which management has refused to revise | Audit results report – July 2020 |
| Auditors report | • Any circumstances identified that affect the form and content of our auditor's report | Audit results report – July 2020 |
| Fee Reporting | • Breakdown of fee information when the audit plan is agreed<br>• Breakdown of fee information at the completion of the audit<br>• Any non-audit work | Audit Planning report – March 2020<br>Audit results report – July 2020 |

# 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.<br>• 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 entity's internal control.<br>• Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.<br>• Concluding on the appropriateness of management's use of the going concern basis of accounting.<br>• 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.<br>• Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the London Fire Commissioner to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the London Fire Commissioner reporting appropriately addresses matters communicated by us to the London Fire Commissioner and reporting whether it is materially inconsistent with our understanding and the financial statements; and<br>• 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 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.