Isle of Wight Council
Audit planning report

Year ended 31 March 2021

June 2021

Building a better working world

29 June 2021

Isle of Wight Council
County Hall
High Street
Newport, Isle of Wight
PO30 1UD

Dear Audit 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 auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2020/21 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2020 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 updated 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 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 26 July 2021 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Helen Thompson

For and on behalf of Ernst & Young LLP

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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 Audit Committee and management of Isle of Wight Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Isle of Wight 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 Committee and management of Isle of Wight 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 2020/21 audit strategy

Overview of our 2020/21 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit 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
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.
Risk of fraud in revenue and expenditure recognition, through inappropriate capitalisation of revenue expenditure	Fraud risk/ Significant risk	No change in risk; refocused	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. We have assessed the risk is most likely to occur through the inappropriate capitalisation of revenue expenditure.
Valuation of Investment Property and land and buildings valued at Existing Use Value (EUV)	Significant risk	No change in risk or focus for IP; Increased risk to significant for EUV properties due to continued uncertainties in the market	The fair value of Investment Property (IP) and the valuation of land and buildings valued at EUV represents significant balances in the Council's accounts and is subject to valuation changes, impairment reviews and market fluctuations. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. Due to continued uncertainties in the market, we have kept this risk as significant for IP and also designated EUV properties as a significant risk in our risk assessment.
Valuation of Land and Buildings valued at Depreciated Replacement Cost (DRC)	Inherent risk	No change in risk or focus	The fair value of Property, Plant and Equipment (PPE) valued at DRC represents a significant balance in the Council's accounts and are subject to valuation changes and impairment reviews. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.
PFI Accounting	Inherent risk	No change in risk or focus	The Council has one PFI arrangement, which is material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal specialist when the PFI was introduced. We will review the accounting entries and disclosures in relation to PFI in detail in 2020/21, with a focus on any significant changes since the specialist's review.
Pension Liability Valuation	Inherent risk	No change in risk or focus	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 for which it is also the administering body. 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.

Overview of our 2020/21 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit 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
Accounting for Covid-19 related government grants	Inherent Risk	New area of focus	The Council has received a significant level of government funding in the relation to Covid-19. There is a need for the Council to ensure that it is has recognised and accounted for these appropriately, taking into account any associated restrictions and conditions.
Going Concern Disclosure	Inherent risk	No change in risk or focus	Covid-19 has created a number of financial pressures throughout local government, increasing service demand and expenditure. The Authority has incurred additional expenditure in a number of areas of its operations and has experienced income losses in parking, commercial and leisure services. The extent of support from MHCLG has developed over time, but does not include all financial consequences of Covid-19. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2020/21 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements.

Overview of our 2020/21 audit strategy

Materiality

Planning materiality

£5.097m

Materiality has been set at £5.097m, which represents 1.3% of the prior year's gross expenditure on provision of services. This is an increase from the prior year from 1% of prior year's gross expenditure to 1.3% on the basis that at this level any potential material misstatement would not result in the Council's general fund balance breaching the minimum level set by the S151 Officer.

Performance materiality

£3.822m

Performance materiality has been set at £3.822m, which represents 75% of planning materiality.

Audit differences

£255k

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet and collection fund) greater than £0.255m. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Committee.

Overview of our 2020/21 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 Isle of Wight Council give a true and fair view of the financial position as at 31 March 2021 and of the income and expenditure for the year then ended; and

- Our commentary on your arrangements to secure value for money in your use of resources for the relevant period.

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.

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, 15 and 16 in recent years as well as the expansion of factors impacting the value for money reporting. Therefore to the extent any of these are relevant in the context of Isle of Wight Council's audit, we will discuss these with management as to the impact on the scale fee.

Overview of our 2020/21 audit strategy

Value for money conclusion

One of the main changes in the NAO's 2020 Code is in relation to the value for money conclusion and we communicated these changes in our Outline Audit Plan presented at the 15 March 2021 Audit Committee meeting. In summary:

- We are still required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.
- Planning on VFM and the associated risk assessment is now focused on gathering sufficient evidence to enable us to document our evaluation of the Council's arrangements, to enable us to draft a commentary under three reporting criteria (see below). This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations.
- We will be required to provide a commentary on the Council's arrangements against three reporting criteria:
    - Financial sustainability - How the Council plans and manages its resources to ensure it can continue to deliver its services;
    - Governance - How the Council ensures that it makes informed decisions and properly manages its risks; and
    - Improving economy, efficiency and effectiveness - How the Council uses information about its costs and performance to improve the way it manages and delivers its services.
- Within the audit opinion we will still only report by exception where we are not satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- The commentary on arrangements will be included in a new Auditor's Annual Report which we will be required to issue at a date to be determined by the NAO.

We include further details of our VFM planning risk assessment in Section 3.

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.

	What is the risk?	What will we do?
Misstatements due to fraud or error*	The financial statements as a whole are not free of material misstatements whether caused by fraud or error. 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. We have considered the areas in which management could seek to override controls at Isle of Wight Council, and this had fed into our consideration of the risk of fraud in revenue and expenditure recognition as set out on page 12.	We will: • Identify fraud risks during the planning stages. • Enquire of management about risks of fraud and the controls put in place to address those risks. • Understand the oversight given by those charged with governance of management's processes over fraud. • Consider the effectiveness of management's controls designed to address the risk of fraud. • Perform mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements. • Review accounting estimates for evidence of management bias. • Evaluate the business rationale for significant unusual transactions.

Our response to significant risks (continued)

Risk of fraud in revenue and expenditure recognition, through inappropriate capitalisation of revenue expenditure*

Financial statement impact

We have assessed that the risk of fraud in revenue and expenditure recognition is most likely to occur through the inappropriate capitalisation of revenue expenditure. This would have the impact of reducing revenue expenditure and increasing additions to Property, Plant and Equipment.

The value of PPE additions in 2019/20 was £36m. The Council's forecast 2020/21 capital programme expenditure as reported at Q3 is £38.9m.

What is the risk?

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.

We have assessed that the risk is most likely to occur through the inappropriate capitalisation of revenue expenditure, as there is an incentive to reduce expenditure which is funded from Council Tax.

What will we do?

We will:

- Test PPE additions using lowered testing thresholds, to ensure they are appropriately supported by documentary evidence, and that the expenditure incurred and capitalised is clearly capital in nature; and
- Seek to identify and understand the basis for any significant journals transferring expenditure from non-capital codes to PPE additions or from revenue to capital codes on the general ledger at the end of the year.

Our response to significant risks (continued)

Valuation of Investment Properties and land and buildings valued at Existing Use Value (EUV)	What is the risk?
	The fair value of Investment Property (IP) and properties valued at EUV represents significant balances in the Authority's accounts and is subject to valuation changes, impairment reviews and market fluctuations. Management is required to make material judgements and apply estimation techniques to calculate the year-end balance recorded in the balance sheet. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates. The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, has issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty in the valuations at year-end. Since late March 2020 in the UK, Covid-19 has had a dramatic impact on the occupation of buildings due to the forced closure of restaurants, retail stores, leisure, offices and hotels due to government regulation and this continues to be a factor for 2020/21. Although government's measures have gradually relaxed, the long term effects remains uncertain. Rental income may not be at levels pre-pandemic even after market recovery and there could still be increased levels of tenant defaults or negotiations for rent reductions as they can no longer trade effectively. This could have a significant impact on investment properties and properties valued at EUV and we have therefore raised a significant risk in relation to these type of valuations.

Financial statement impact	What will we do?
The fair value of investment properties in the 2019/20 audited accounts at 31 March 2020 was £33.1million and the value of EUV assets £15 million.	• Consider the work performed by the Authority's valuer, 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 and challenge the key assumptions used by the valuer and also ensure that all IP has been revalued in-year. • Test accounting entries to ensure that they have been correctly processed in the financial statements. • For EUV assets, 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. We will also consider if there are any specific changes to assets that have occurred and whether these have been communicated to the valuer; • For EUV assets, review assets not subject to valuation in 2020/21 to confirm that the remaining asset base is not materially misstated • Ensure that appropriate disclosure has been made in the financial statements concerning any the material uncertainties disclosed by the valuer. • Obtain input from EY Real Estates, our internal specialists on asset valuations for Investment Properties and EUV assets, including inputs on market sentiment and how it has been reflected in the estimated rental values/yields.

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.

What is the risk/area of focus?	What will we do?
Valuation of Land and Buildings (DRC) The fair value of PPE represents a significant balance in the Council's accounts and is subject to valuation changes and impairment reviews. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	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 and challenge the key assumptions used by the valuer; • 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. We will also consider if there are any specific changes to assets that have occurred and whether these have been communicated to the valuer; • Review assets not subject to valuation in 2020/21 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 to confirm that accounting entries have been correctly processed in the financial statements.
PFI accounting The Council has one PFI arrangement, which is material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal specialist when the PFI was introduced. We will review the accounting entries and disclosures in relation to PFI in detail in 2020/21, with a focus on any significant changes since the specialist's review.	We will: • Review assurances brought forward from prior years regarding the appropriateness of the PFI financial model; • Review the PFI financial model for any significant changes, and if identified consider engaging relevant experts to review the model to ensure it is still working as expected; • Ensure the PFI accounting model has been updated for any service or other agreed variations and confirm consistency of the current year model with prior year brought forward assurances; and • Agree outputs of the model to the accounts, including balances and disclosures for assets, liabilities, and expenditure, and review the completeness and accuracy of disclosures.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Pension Liability Valuation 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, for which the Council is also the administering body. 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. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the 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. In prior years the 'McCloud' judgement impacted the estimate and there may be further developments in this area, potentially again coming after the balance sheet date.	We will: • Liaise with the auditors of Isle of Wight Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Isle of Wight Council; • Assess the work of the Pension Fund actuary (Hymans Robertson) 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; and • Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.
Accounting for Covid-19 related grant funding The Council has received a significant level of government funding in relation to Covid-19. Whilst there is no change in the CIPFA Code or accounting standard (IFRS 15) in respect of accounting for grant funding, the emergency nature of some of the grants received and in some cases the lack of clarity on any associated restrictions and conditions, means that the Council will need to apply a greater degree of assessment and judgement to determine the appropriate accounting treatment in the 2020/21 statements.	We will: Consider the Council's judgement on material grants received in relation to whether it is acting as: • Agent, where it has determined that it is acting as an intermediary; or • Principal, where the Council has determined that it is acting on its own behalf. We will ask the finance team to provide its assessment of grant accounting well before it prepares the statements so that we can provide an early view on its proposed accounting treatment. We will also seek to ensure that grants, for example the local government income compensation scheme for lost sales, fees and charges, have been claimed and recognised in accordance with scheme rules.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Going concern	
Covid-19 has created a number of financial pressures throughout local government, increasing service demand and expenditure. The Authority has incurred additional expenditure in a number of areas of its operations and has experienced income losses in parking, commercial and leisure services. The extent of support from MHCLG has developed over time, but does not include all financial consequences of Covid-19. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2020/21 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements.	In light of the unprecedented nature of Covid-19, its impact on the funding of public sector entities and uncertainty over the form and extent of government support, we will be seeking a documented and detailed consideration to support management's assertion regarding the going concern basis and particularly with a view whether there are any material uncertainties for disclosure. We will review your going concern disclosures within the financial statements under IAS1, and associated financial viability disclosures within the Narrative Statement. We expect you to disclose any material uncertainties that do exist. These disclosures should also include the process that has been undertaken for revising financial plans and cashflow, liquidity forecasts, known outcomes, sensitivities, mitigating actions including but not restricted to the use of reserves, and key assumptions (e.g. assumed duration of Covid-19 impact on the Council's finances). Our audit procedures to review these will include consideration of: • Current and developing environment; • Liquidity (operational and funding); • Mitigating factors; • Management information and forecasting; and • Sensitivities and stress testing.

03 Value for Money Risks

Value for money

Council responsibilities for value for money

The Council is required to maintain an effective system of internal control that supports the achievement of its policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

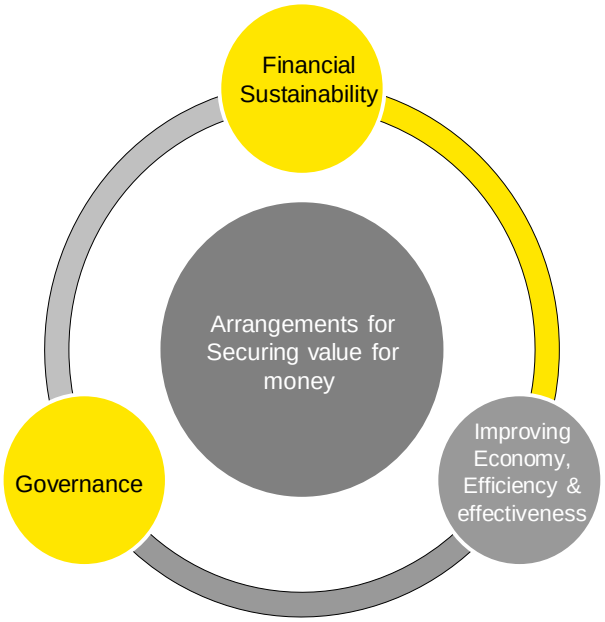
As part of the material published with its financial statements, the Council is required to bring together commentary on its governance framework and how this has operated during the period in an annual governance statement. In preparing its annual governance statement, the Council tailors the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on its arrangements for securing value for money from their use of resources.

Auditor responsibilities under the new Code

Under the 2020 Code we are still required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. However, there is no longer overall evaluation criterion on which we need to conclude. Instead, the 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Council a commentary against specified reporting criteria (see below) on the arrangements the Council has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

- Financial sustainability
  How the Council plans and manages its resources to ensure they can continue to deliver its services;
- Governance
  How the Council ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness:
  How the Council uses information about its costs and performance to improve the way it manages and delivers its services.



Value for money risks

Planning and identifying VFM risks

The NAO's guidance notes require us to carry out a risk assessment which gathers sufficient evidence to enable us to document our evaluation of the Council's arrangements, in order to enable us to draft a commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations. This is a change to 2015 Code guidance notes, where the NAO required auditors, as part of planning, to consider the risk of reaching an incorrect conclusion in relation to the overall criterion.

In our Outline Audit Plan presented at the 15 March meeting of the Audit Committee we included details of the new NAO Code of Audit Practice (the Code) in respect of VFM and outlined that at that time we had not yet commenced our VFM planning risk assessment work. We are required to carry out sufficient work to enable us to provide a commentary against the following arrangements shown on the next page.

Where our planning work has identified a risk of significant weakness, the NAO's guidance requires us to consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including where appropriate, challenge of management's assumptions. We are required to report our planned procedures to the audit committee.

Risk assessment

We have now completed our assessment of the risk of significant weaknesses in the arrangements outlined in the following page. We have based our assessment on a combination of our cumulative audit knowledge and experience, our review of Council, Cabinet and committee reports, meetings with management and evaluation of associated documentation through our regular engagement with the Council and the finance team. We have not identified a risk of significant weakness at the planning stage.

Reporting

The NAO is cognisant of the pressures facing local authorities and auditors to meet their reporting requirements for 2020/21 whilst dealing with the challenges and issues presented by the pandemic and have confirmed the following requirements:

1. The Code requires auditors to report by exception within the auditor's opinion on the financial statements if they have identified a significant weakness in VFM arrangements, i.e. if auditors have not identified a significant weakness then the audit opinion does not include reporting in respect of VFM. For 2020/21, the NAO's revised guidance allows auditors to issue the audit opinion even when the auditor has not concluded on their VFM work to address identified risks of significant weaknesses in arrangements, as long as the risks do not impact the financial statements. We expect to complete all our planned VFM procedures, which include revisiting the risk assessment, before we issue the auditor's opinion.
2. The Code requires auditors to issue their commentary on VFM as part of a new Auditor's Annual Report (AAR), at the same time as they issue their audit opinion on the financial statements. For 2020/21 the NAO's revised guidance allows auditors to issue the commentary on VFM and AAR after they issue their audit opinion on the financial statements.
3. We expect to issue the VFM commentary and AAR shortly after issuing the audit opinion on the financial statements.

Value for money risks

Financial sustainability

How the Council plans and manages its resources to ensure it can continue to deliver its services.

1. How the Council ensures that it identifies all the significant financial pressures that are relevant to its short and medium-term plans and builds these into them.
2. How the Council plans to bridge its funding gaps and identifies achievable savings.
3. How the Council plans finances to support the sustainable delivery of services in accordance with strategic and statutory priorities.
4. How the Council ensures that its financial plan is consistent with other plans such as workforce, capital, investment, and other operational planning which may include working with other local public bodies as part of a wider system.
5. How the Council identifies and manages risks to financial resilience, e.g. unplanned changes in demand, including challenge of the assumptions underlying its plans.

Governance

How the Council ensures that it makes informed decisions and properly manages its risks.

1. How the Council monitors and assesses risk and how the Council gains assurance over the effective operation of internal controls, including arrangements to prevent and detect fraud.
2. How the Council approaches and carries out its annual budget setting process.
3. How the Council ensures effective processes and systems are in place to ensure budgetary control; to communicate relevant, accurate and timely management information (including non-financial information where appropriate); supports its statutory financial reporting requirements; and ensures corrective action is taken where needed.
4. How the Council ensures it makes properly informed decisions, supported by appropriate evidence and allowing for challenge and transparency. This includes arrangements for effective challenge from the audit committee.
5. How the Council monitors and ensures appropriate standards, such as meeting legislative/regulatory requirements and standards in terms of staff or NED behaviour (such as gifts and hospitality or declarations/conflicts of interests).

Improving economy, efficiency and effectiveness

How the Council uses information about its costs and performance to improve the way it manages and delivers its services.

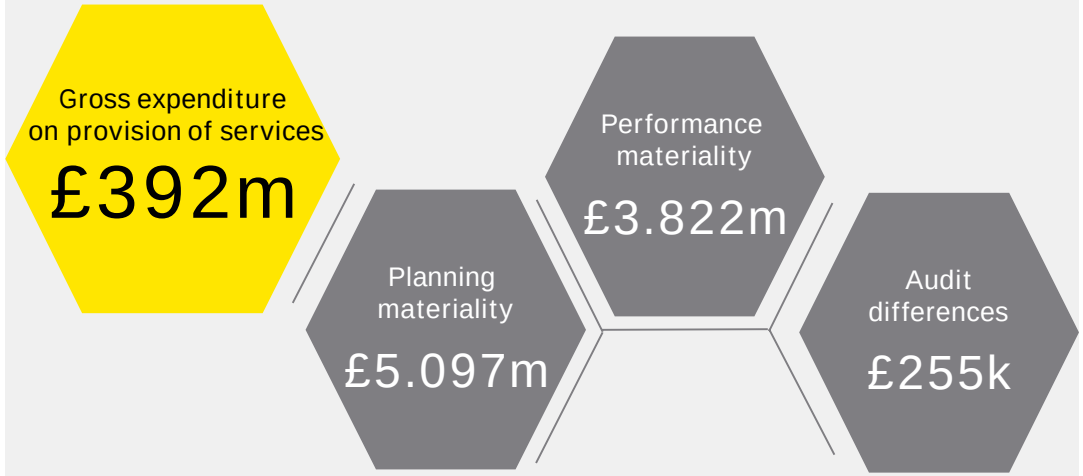
1. How financial and performance information has been used to assess performance to identify areas for improvement;
2. How the Council evaluates the services it provides to assess performance and identify areas for improvement;
3. How the Council ensures it delivers its role within significant partnerships, engages with stakeholders it has identified, monitors performance against expectations, and ensures action is taken where necessary to improve; and
4. Where the Council commissions or procures services, how the Council ensures that this is done in accordance with relevant legislation, professional standards and internal policies, and how the Council assesses whether it is realising the expected benefits

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2020/21 has been set at £5.097m. This represents 1.3% of the Council's prior year gross expenditure on provision of services and is an increase from the prior year as explained in section one. It will be reassessed throughout the audit process. We have set materiality using gross revenue expenditure as our expectation is that users of the Council's accounts are focussed on how it uses its resources to provide services to local people. We have used 1.3% based on our assessment of the Council's financial position, levels of public interest, lack of planned reorganisations and sources of borrowing. We have provided supplemental information about audit materiality in Appendix C.



We request that the Audit 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 £3.822m which represents 75% of planning materiality. The rationale for using 75% is based on the anticipation of identifying few or no errors during the audit. This expectation has been built on our experience of the Council in prior years.

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 collection fund. 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 Committee, or are important from a qualitative perspective.

Specific materiality – We are no longer required to set a separate materiality for the Firefighters Pension Fund statements. In previous years we have set this at 1% of Benefits Paid. We have set a separate materiality of £2.5k for remuneration disclosures, related party transactions, members' allowances 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 these areas. This specific materiality is based on 1% of our audit differences threshold.

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.

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 and report a commentary on those arrangements.

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 2020/21 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 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 procedures, where they raise issues that could have an impact on the financial statements, the Narrative Statement or the Annual Governance Statement.

06 Audit team

Audit team

Audit team structure:

Helen Thompson
Associate Partner

Jason Jones
Manager

Xi Jiang
Senior
Zolani Mzinani
Senior

Working together with the Council

We are working together with officers to identify continuing improvements in communication and processes for the 2020/21 audit.

We will continue to keep our audit approach under review to streamline it where possible.

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	John Prince (Principals Surveyors) – Council's external valuer of land and buildings Avison Young – Council's external valuer of investment property
Pensions disclosure	PwC as consulting actuary appointed by the NAO, and EY internal pensions specialists Hymans Robertson – Actuary to Isle of Wight Council Pension Fund
Business Rates appeals provision	Analyse Local – Council's external valuer of appeals provision

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
- 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 2020/21.

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

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes Walkthroughs of key systems and processes	March	Audit Committee	Outline Audit Plan
Interim audit testing Walkthroughs of key systems and processes	April		
	May		
	June		
	July	Audit Committee	Audit Planning Report
Year end audit Audit Completion procedures	August		
Year end audit Audit Completion procedures	Autumn	Audit Committee	Audit Results Report Audit opinions and completion certificates
	Winter	Audit Committee	Auditor's Annual Report

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 December 2019, 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; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence.	▸ 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; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ 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; ▸ Details of any non-audit/additional services to a UK PIE audit client where there are differences of professional opinion concerning the engagement between the Ethics Partner and Engagement Partner and where the final conclusion differs from the professional opinion of the Ethics Partner ▸ 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; ▸ Details of all breaches of the IESBA Code of Ethics, the FRC Ethical Standard and professional standards, and of any safeguards applied and actions taken by EY to address any threats to independence; and ▸ 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 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 Helen Thompson, 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, 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, no non-audit services have been undertaken, therefore the current ratio of non-audit fees to audit fees is zero. 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.

Relationships, services and related threats and safeguards

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.

Familiarity threats

Engagement lead appointments are subject to rotation every 5 years with any extensions subject to approval by Public Sector Audit Appointments Ltd (PSAA). Helen Thompson has been the engagement lead for Isle of Wight Council for the past 5 years and 2020/21 will be the sixth year. Due to the significant changes to the VFM approach this year, the firm requested approval from PSAA for the 2 year extension to engagement lead appointments. This has been approved by PSAA and we have obtained approval from this Committee as well as management, with no perceived independence threats.

Other threats

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

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

Other communications

EY Transparency Report 2020

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 30 June 2020 and can be found here:

EY UK Transparency Report 2020 | EY UK

09 Appendices

Appendix A

Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2020/21 accounts of opted-in principal local government and police bodies.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the 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 2020/21	Scale fee 2020/21	Final Fee 2019/20
	£	£	£
PSAA Scale Fee	98,602	98,602	98,602
Covid 19 – Going Concern and consultation (1)	5,000	N/A	5,952
Covid 19 – increased property valuation risk (1)	6,000	N/A	6,892
IAS 19 – McCloud considerations (1)	1,500	N/A	1,780
2019/20 Objection (1)	-*	N/A	20,175 (3)
Scale fee plus in-year variations	*111,102*	*98,602*	*133,401*
Scale fee rebasing (2)	41,302	41,302	41,302
Total fees	152,404	139,904	174,703

All fees exclude VAT

(1) The 2019/20 Code work includes an additional fee of £34,799, for additional work undertaken in relation to going concern, property valuations, pension valuations and the objection received from the public. This additional fee is subject to approval from PSAA.

(2) Changes in work required to address professional and regulatory requirements and scope associated with risk. Details of this scale fee rebasing exercise was also communicated in our 2019/20 Annual Audit Letter and our 2020/21 Outline Audit Plan. PSAA have yet to make their final decision.

(3) The objection work remains ongoing and this fee is likely to increase.

For 2020/21, the scale fee will be further impacted by a range of factors which may result in additional work. We set out an estimate of the potential additional fee for this below based on the fee charged in 2019/20. However, this could go up or down. The issues we have identified at the initial planning stage which could impact on the fee include:

- The need to engage EY Real Estate to review a sample of valuations of investment properties and EUV assets c.£6,000
- Review of additional disclosures that will be required in relation to going concern and our internal consultation process, c.£5,000
- Additional work in relation to any McCloud considerations impacting the pension fund valuation, c.£1,500

In addition, we are driving greater innovation in the audit through the use of technology. The significant investment costs in this global technology continue to rise as we seek to provide enhanced assurance and insight in the audit.

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

- Officers meet the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion are 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.

Appendix B

Required communications with the Audit Committee

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

		Our Reporting to you
Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the Audit 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 – July 2021
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Audit results report – September 2021

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	Audit results report – September 2021
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	Audit results report – September 2021
Fraud	• Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud	Audit results report – September 2021
Related parties	• Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	Audit results report – September 2021

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Audit planning report – July 2021 Audit results report – September 2021
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report – September 2021
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 • Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Committee may be aware of	Audit results report – September 2021
Internal controls	• Significant deficiencies in internal controls identified during the audit	Audit results report – September 2021
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report – September 2021
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report – September 2021
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit results report – September 2021
Fee Reporting	• Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Audit planning report – July 2021 Audit results report – September 2021

Appendix C

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 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. • Reading other information published with the financial statements, and reporting whether it is materially inconsistent with our understanding and the financial statements; and • Maintaining auditor independence.

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.