13 November 2024

Chair of Audit and Procurement Committee
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Dear Cllr Lakha

## Coventry City Council and group - Conclusion of the audit for 2020/21– letter to those charged with governance on the application of the local authority backstop

As you will be aware, on 5 September 2024 parliament approved the Accounts and Audit (Amendment) Regulations 2024. These Regulations set a publication date for financial statements up to and including 2022/23 by 13 December 2024. The new National Audit Office Code, which is expected to be approved on 14 November 2024, also requires that auditors should issue their audit report in time for the relevant authority to publish its accounts by the specified date in those Regulations. Where audit work is not concluded, this will result in either a qualification or disclaimer of opinion.

As discussed with your Director of Finance and Resources, and for reasons which I set out in more detail below, it will not be possible for us to complete our audit for 20202/21 by the statutory backstop date. We therefore propose to issue a disclaimer of our audit opinion. I attach a draft copy of this disclaimer for the attention of the Audit Committee.

We are required under Auditing Standards to report certain matters to the Audit Committee, including our responsibilities as auditor, the scope of the audit, independence, audit fees and any matters arising from the audit. I set out more details on the audit below. Information regarding our responsibilities, the scope of the audit and fees are included in the Appendix.

### Outcome of our audit for 2020/21– Disclaimer of the opinion on the financial statements

Unfortunately, for reasons set out below, it will not be possible for us to undertake sufficient work to support an audit opinion by the statutory deadline of 13 December 2024. This means that the limitations of scope imposed by the backstop are pervasive and therefore we have been unable to form an opinion on the financial statements by the due date. We therefore plan to issue a disclaimer of the audit opinion. We have attached the draft wording of our Audit Report for your information.

The 2020/21 audit has been challenging due to various reasons. We issued our 2020/21 audit plan in July 2021 but since that time there have been delays in progressing the audit due to significant issues identified in the prior year. These issues were set out in detail in our 2019/20 audit findings report which was discussed at the 9th October 2023 meeting of the Audit and Procurement Committee. In summary, these issues related primarily to the accounting of property, plant and equipment, and to the accounting for group entities. Tackling these issues meant that the 2019-20 audit was not concluded until October 2023 and the Council did not publish its draft 2020/21 accounts until 28 March 2024.

Prior to publishing its 2020/21 draft accounts, management provided us with a preliminary version of the 2020/21 accounts (excluding group figures), upon which we were able to begin our audit procedures for areas of the accounts not expected to be affected by the delays. A significant amount of audit work was started; however, the audit was put on hold, largely due to efforts of the finance team being re-focused on the completion of the 2019/20 audit, and more recently on the catch up of publishing delayed accounts for the four years 2020/21 – 2023/24. All these factors have resulted in a position where a significant amount of audit work has been carried out, but no final conclusions have been reached ahead of the 13th December 2024 backstop date. Considering this, discussions were held with the Director of Finance and Resources and yourself regarding the resourcing implications. It was agreed that it was no longer feasible to complete the 2020/21 audit ahead of the backstop date, leading to a decision to prioritise resources on the recovery of assurance, starting with the audit of the Council's 2023/24 financial statements.

**Outcome of this year's audit - Value for Money work and other work under the National Audit Office Code of Audit Practice**

We finalised our Value for Money work in July 2022 and we reported the outcome in two documents: our Interim Auditor's Annual Report; and our Auditors VfM Report on Company Governance. These were discussed with the Audit and Procurement Committee at the 25 July 2022 meeting. The key findings include:

- No significant weaknesses in arrangements identified, but improvement recommendations made in the areas of: financial sustainability, governance, and improving economy, efficiency and effectiveness.

- No risk of significant weakness was identified in the Council's COVID-19 arrangements.

- In relation to group governance, a series of improvement recommendations were made. These related to oversight, business planning, skills and accounting.

We are also required to report by exception if we have applied any of our statutory powers or duties.

We have nothing to report in respect of the above.

**Independence**

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention and consider that an objective reasonable and informed third party would take the same view. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

**Management letter of representation**

We have asked management to provide a letter of representation in respect of the financial statements for 2020/21. This will be tabled as a separate agenda item.

**Looking ahead**

The circumstances resulting in the application of the local authority backstop are clearly extremely unusual. The government has signalled its intent that where backstops have been applied, local authorities and their auditors work together to recover the position over subsequent years. We will follow relevant guidance including from the NAO and the FRC to work with you over the coming year, as we seek to rebuild audit assurance.

Yours sincerely

***Mark Stocks***

For Grant Thornton UK LLP

CC  Director of Finance and Resources

Attachments: Draft Disclaimer of Opinion

# Appendix

**Responsibilities**

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of Coventry City Council. We draw your attention to both of these documents.

**Scope of our audit**

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the Council and group's financial statements that have been prepared by management with the oversight of those charged with governance (the Audit committee); and we consider whether there are sufficient arrangements in place at the Council and group for securing economy, efficiency and effectiveness in your use of resources. Value for money relates to ensuring that resources are used efficiently in order to maximise the outcomes that can be achieved.

The audit of the financial statements does not relieve management or the Audit Committee of its responsibilities. It is the responsibility of the authority to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the authority is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the authority's business and is risk based.

**Audit Plan**

We issued an Audit Plan on 26th July 2021. In our plan we identified the following issues as significant audit risks:

- Fraud in revenue recognition- this ISA 240 presumed risk was rebutted
- Fraud in expenditure recognition – this ISA 240 presumed risk was rebutted
- Management over-ride of controls
- Valuation of land and buildings and investment properties
- Valuation of pension fund net liability
- Accounting for the Group and Long-Term Investments.

We have not identified any other significant risks since the date we issued our audit plan.

**Our approach to materiality**

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

For 2020/21 we set a materiality level of £12m for the Council and £12.2m for the group.

**Key financial reporting and audit issues identified during the audit**

As we have not completed our detailed work in respect of the 2020/21 financial statements audit, we are only able to report issues to you which we have noted up to the point of issuing our disclaimer opinion.

The issues that we wish to highlight for your attention are as follows.

The draft accounts published in March 2024 contain materially different figures across the primary statements and notes to the accounts when compared to the preliminary version of the 2020/21 accounts provided to audit in June 2022. We have not audited the adjustments made between these versions.

The following issues all relate to findings during the 2020/21 audit, which affected both the 2020/21 accounts and the 2019/20 accounts. These issues were appropriately adjusted for in the final 2019/20 accounts, as reported in our 2019/20 audit findings report. Adjustments in the 2020/21 accounts have not been audited.

- Historic cost depreciation - it was noted during the 20/21 audit that accumulated depreciation was significantly higher than expectations, given the regularity of revaluation on PPE. Upon further investigation by the Council, a historic error dating back to the implementation of the Business World system (Agresso) in 2011/12 was identified where downward revaluation on PPE assets had been improperly accounted for. The accounts at the time treated the movements as impairments by decreasing the net book value of the assets through accelerated depreciation, instead of correctly reducing the gross book value of the assets. However, within the fixed asset register (FAR) these were correctly treated as a revaluation and the gross book value of assets and depreciation were reduced. The resulting impact of this was a difference between the FAR and the Council's accounts.

  As the 2019/20 audit was still open at the time we identified this issue, the adjustment was processed in the 2019/20 accounts. The difference in 2019/20 was a c.£380m equal and opposite overstatement in both gross book value and accumulated depreciation. There was no impact on the Net Book Value of the assets or the assets held by the Council. We discussed this with management, and as it was not possible to determine what the appropriate treatment was in 2011/12 (as records are not available), we agreed that it is appropriate to restate the 2019/20 financial statements to reflect the fixed asset register. This resulted in a c£380m adjustment to both gross asset values and gross depreciation. This was reported in our 2019/20 Audit Findings Report.

  In 2020/21 we note a similar £386m adjustment has been made between the preliminary accounts received and the published draft accounts indicating this adjustment has been appropriately applied in 2020/21 as well, however we have not audited the accuracy of the adjustment made in 2020/21.

- Changes in Valuation Methodology - The Council engaged an external valuer, Wilks, Head & Eve, to perform PPE valuations in the year ended 31 March 2021, succeeding from the internal valuers at the Council in previous financial years. The external valuers highlighted five assets where they opted to value using a Depreciated Replacement Cost (DRC) approach deeming the assets as specialist, i.e. where there may not be an accurate market value. Upon review of previous valuations of these assets, it was identified that in prior years that the assets had been valued using rateable values of the property as a proxy in lieu of market rents. The engagement team deemed that this was not an appropriate approach to valuation of assets.

  The assets were subsequently revalued by Wilks, Head & Eve resulting in upwards revaluation adjustments: a prior period adjustment to the opening balance at 1 April 2018 of £6.5m, a prior period adjustment to the closing balance at 31 March 2019 of £6.5m, and an adjustment to the closing balance at 31 March 2020 of £6.3m.

  These were all adjusted for in the 2019/20 accounts as reported in our 2019/20 Audit Findings Report, however we have not audited the accuracy of the adjustment made in 2020/21.

- Errors in Non-Operational Asset Valuations - There were errors in 2019/20 noted on 5 non-operational assets following a review of valuation movements from 2019/20 compared with 2020/21. These errors related to: inaccurate lease data used within the valuation, incomplete site size / not all units included in the valuation, incorrect reversionary rents used by the valuers.

  The errors led to a prior period adjustment in the 2019/20 accounts to the opening balance at 1 April 2018 of £3.8m; a prior period adjustment to the closing balance at 31 March 2019 of £6.4m, and an adjustment to the closing balance at 31 March 2020 of £8.3m.

These were all adjusted for in the 2019/20 accounts as reported in our 2019/20 Audit Findings Report, however we have not audited the accuracy of the adjustment made in 2020/21.

**Summary of work carried out**

Although we are unable to reach conclusion of our audit, a significant amount of work has been carried out, including:

- Audit planning, including understanding the entity, group and its environment; documenting business processes; understanding the design and implementation of controls including IT controls; making inquiries of management and others; risk assessment and scoping the audit; culminating in the issuing of our audit plan in July 2021.

- Review of the preliminary financial statements by the Engagement Partner, Audit Manager, and technical team and feedback to management on points of interest.

- Engagement of auditor's experts who assisted with testing of property valuations and investment valuations.

- Engaging with the Pension Fund auditor to request assurances in relation to the Pension Fund.

- Discussions with management throughout the extended period.

- Discussions among the audit team.

- Discussions with component auditors and review of their work. This was abortive work following adoption of the revised ethical standard. See' Matters in relation to the Group audit' section, below.

- Value for money work, culminating in the issuing of two documents: our Interim Auditor's Annual Report; and our Auditors VfM Report on Company Governance in July 2022.

- Selecting samples and beginning to test transactions and balances. Where findings impacted 2019/20, ensuring these were remediated in the 2019/20 accounts. In particular, the following audit work was carried out but not finalised:

  In relation to significant risks:

  - Journals- risk assessment procedures were carried out on transactions, including documenting an understanding of the control environment, walking through controls, making inquiries of journal posters, analysing transactions, and holding discussions among the audit team to identify large and unusual entries that we would test further. Furthermore, a significant piece of work was carried out in response to IT control findings – refer to the Design Effectiveness of Internal Control section later in this appendix, for details of our findings.

  - Property valuations- risk assessment procedures were carried out on valuations and on assets that weren't valued in the year, including documenting an understanding of the related processes and controls, walking through controls, assessing the competence, experience and capability of management's expert, obtaining valuation reports, analysing movements since the last valuation and comparing this to expected movements, challenging management on the value of assets that weren't revalued in year, engaging with our expert to: 1) evaluate the instructions sent by management to the valuer; 2) evaluate the valuation report issued by the valuer; and 3) assist with the testing of the reasonableness of assumptions underpinning valuations; selecting a sample of high risk valuations;

and testing the underlying assumptions and accounting. We had relevant findings, see the ‘ Key financial reporting and audit issues identified during the audit’ section earlier in this report.

- Pension liability valuation- risk assessment procedures were carried out on the pension liability valuation, including documenting an understanding of the related processes and controls, walking through controls, assessing the competence, experience and capability of management’s expert, obtaining actuarial reports, requesting assurances from the auditor of the Pension Fund, agreeing the pension disclosures in the preliminary accounts to the actuary reports, testing the upfront payment made to the pension fund and related disclosures, comparing assumptions used by the actuary to those recommended by our expert, and starting work on comparing figures to expectations we had developed.

- Group accounting and Long-Term Investment valuation- holding discussions with management as they prepared the group accounts, obtaining valuation reports for investments in companies, engaging auditor experts to review valuations of long term investments, specifically in Birmingham Airport Holdings and the Coventry and Solihull Waste Disposal Company, including the underlying assumptions and source data used, testing the entries in the preliminary accounts to valuation reports. Considering the rationale for a nil valuation of UKBIC.

In relation to other material financial statement line items:

- Writing to the banks and other institutions to confirm the cash, investment and borrowing balances at the year end.

- Selecting and testing samples for: PPE balances, additions, REFCUS, debtors, creditors, fees and charges, grant income, income and expenditure around the year end, non-pay expenditure, and grants received in advance.

- Carrying out analytical procedures on depreciation, payroll costs and collection fund income

- Testing statements and disclosures including: the movement in reserves statement and supporting notes, the cash flow statement, the expenditure and funding analysis and related notes, officer remuneration notes, the related party note, the collection fund statement, the financial instruments notes, provisions and PFI notes.

**Going Concern**

As auditors, we are required to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity’s ability to continue as a going concern (ISA (UK) 570).

In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector.

Practice Note 10 sets out the following key principles for the consideration of going concern for public sector entities:

- the use of the going concern basis of accounting is not a matter of significant focus of the auditor’s time and resources because the applicable financial reporting frameworks envisage that the going concern basis for accounting will apply where the entity’s services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist, and so a straightforward and standardised approach for the consideration of going concern will often be appropriate for public sector entities

- for many public sector entities, the financial sustainability of the reporting entity and the services it provides is more likely to be of significant public interest than the application of the going concern basis of accounting. Our consideration of the authority's financial sustainability is addressed by our value for money work, which is covered elsewhere in this report.

Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by a local authority meets these criteria, and so where undertaking work on your audit, we would normally expect to apply the continued provision of service approach. In doing so, we would consider and evaluate:

- the nature of the authority and the environment in which it operates
- the authority's financial reporting framework
- the authority's system of internal control for identifying events or conditions relevant to going concern
- management's going concern assessment.

As we have been unable to form an opinion on the financial statements, we are unable to draw a conclusion in this area.

**Design effectiveness of internal controls**

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to management.

We wish to highlight the following information for your attention:

Super user access rights:

During a review of control access performed by the IT audit team for the 2020/21 audit, it was identified that there were a small number of finance staff who had privileged administrative access rights within Business World. This presented a heightened opportunity risk for fraud and required substantial work to be performed by the engagement team to gain reasonable assurance over this area.

As the 2019/20 audit remained open at this point, this issue was also addressed in 2019/20. In our 2019/20 Audit Findings Report, we recommended that the Council reviews the administrative access allowed to finance staff through Business World. The Council should ensure that adequate controls are in place to ensure segregation of duties and to prevent fraud.

Lack of journal authorisation control:
There is no authorisation process for journal postings in the finance system. The control environment relies on budgetary processes (i.e. management account review) and access controls, which do not fully compensate for the lack of authorisation controls. We recommend the Council introduce an automated authorisation control designed to ensure segregation of duty with regard to journal postings. We recommend authorisation privileges are limited to appropriate finance managers.

**Other matters which we are required to report on to those charged with governance**

We are required to confirm the following:

- We have not been made aware of any incidents of fraud in the period and no issues have been identified during the course of our audit procedures.

- We are not aware of any related party transactions which have not been disclosed.
- We are not aware of any significant incidences of non-compliance with applicable laws and regulations.

**Matters in relation to the Group audit**

In respect of the group engagement, we are required to report on:

- The scope of work on components
- The involvement of group auditors in significant component audits,
- Any concerns over quality of component auditors' work
- Limitations of scope on the group audit, and
- Fraud or suspected fraud

We were unable to commence work on the group accounts given these were first published on 28th March 2024, and therefore we have no matters to report in this respect, except for the following issue to note:

The Financial Reporting Council's Revised Ethical Standard 2019 became effective from 15 March 2020 and has implications on the reliance we, as group auditors, are able to place on the audit work carried out by the auditors of the group's companies (the component auditors). The Ethical Standard contains certain additional requirements or prohibitions that apply only in the case for public interest entities (PIEs). As a PIE engagement, our audit of Coventry City Council and group is affected by these standards. In practice, this means that due to the additional non-audit services provided by the component auditors to the companies of the group, we are no longer able to place reliance on their work. Instead, for the duration of time that the prohibited services are being provided, we must carry out our own audit procedures on areas that fall within the scope of the group audit.

**Audit fees and non-audit fees**

PSAA set a scale fee for this year's audit of £133,564 + VAT. Given the unusual circumstances of the backstop, we are awaiting a determination from PSAA as to the appropriate fee to be charged for this audit year. However, we estimate that our fee will be £211,000 + VAT.

The fees reconcile to the financial statements as follows:

Audit fees per financial statements: £211,000 + VAT
Less adjustment not yet determined by PSAA £77,436 + VAT
Equals PSAA scale fee: £133,564

We have also undertaken the following non audit work in respect of 2020/21:

| Audit Service | Proposed Fee | Final Fee |
|---|---|---|
| Certification of housing benefit claim | £45,000 | £69,861 |
| Certification of teachers pensions return | £5,000 | £6,000 |
| Certification of Innovate UK grant claims (from April 2019 for 18 months) | £6,000 | £6,000 |

The level of these recurring fees taken on their own is not considered a significant threat to independence in comparison to the total fee for the audit of £211,000 + VAT and in particular relative to Grant Thornton UK LLP's turnover overall. Further there is no contingent element to it. These factors all mitigate any perceived self-interest threat to an acceptable level.

A full listing of non-audit fees chargeable for the periods 2020/21 to the date of this letter is included in the table overleaf.

| Type of Non-audit Service | 20/21 | 21/22 | 22/23 | 23/24 | Threats identified | Safeguards |
|---|---|---|---|---|---|---|
| **Audit-related:** | | | | | | |
| Certification of Teachers Pension Return | £6,000 | £7,500 | £10,000 | £12,500 | Self-Interest (because this is a recurring fee) | The level of this recurring fee taken on its own is not considered a significant threat to independence as the annual fee for this work is low in comparison to the total annual fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. |
| Certification of Housing Benefit Claim | £69,861 | £70,000 | £106,150 | £143,487 | Self-review (because GT provides audit services)<br><br>Management (because GT report to Teachers Pensions/DWP) | To mitigate against the self-review threat, we carry out the certification work after the audit has been completed wherever possible. Errors identified have not been and are not expected to be material.<br><br>The Council has informed management who will decide whether to amend returns for our findings and agree the accuracy of our reports on grants.<br><br>Any changes to subsidy payable will be determined by Teachers Pensions/DWP and we have no involvement in the decision.<br><br>These factors mitigate the perceived threats to an acceptable level. |
| Certification of Innovate UK grant claims in relation to Battery Industrialisation Centre (from April 2019 for 18 months) | £6,000 | - | - | - | Self-review (because GT provides audit services) | The level of this non recurring fee taken on its own is not considered a significant threat to independence as the annual fee was low in comparison to the total annual audit fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.<br><br>To mitigate against the self review threat , the timing of certification work is done after the audit has completed where possible. Amounts are not material to the amounts involved to our opinion and unlikelihood of material errors arising and the Council has informed management who decide whether to amend returns for our findings and agree the accuracy of our reports on grants. |