

**Agenda Item No: 5**

**RAISING THE CLEARLY TRIVIAL REPORTING LIMIT FOR EXTERNAL AUDIT**

*To:* **Audit and Accounts Committee**

*Date:* **20<sup>th</sup> January 2015**

*From:* **Head of Finance**

*Electoral Division(s):* **All**

*Forward Plan Ref:* **N/A**

*Key decision:* **No**

*Purpose:* To review the clearly trivial reporting limit practiced by External Audit as discussed by this Committee at its November meeting.

*Key Issues:* The Audit and Accounts Committee to consider options for the revision of the clearly trivial reporting level.

*Recommendations:* The Audit and Accounts Committee to determine whether the level which the external auditors classify as the threshold for 'clearly trivial' items of income and expenditure should be raised in line with similar authorities.

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## **1.0 BACKGROUND**

- 1.1 ISA (UK&I) 450 requires that external auditors record all misstatements identified except those which are “clearly trivial” i.e. those which the external auditors do not expect to have a material effect on the financial statements even if accumulated. This level was last reviewed by the Audit and Accounts Committee in January 2014.
- 1.2 The overall materiality threshold for Cambridgeshire County Council in 2013/14 was £19,000,000, and was set at 2% of actual expenditure for the year ended 31 March 2014. Cambridgeshire County Council’s ‘Clearly trivial reporting de minimis’ threshold was set at £250,000 for the 2013/14 Statement of Accounts.
- 1.3 ISA (UK&I) 450 paragraph A2 states that “‘Clearly trivial’ is not another expression for ‘not material’. It is limited to matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about this, the matter is considered not to be clearly trivial’. This indicates that ‘clearly trivial’ amounts must not, when aggregated, approach the materiality threshold. For Cambridgeshire County Council, the materiality limit is 76 times greater than the ‘clearly trivial limit’.
- 1.4 A thematic review of the ‘clearly trivial’ limit by the Financial Reporting Council in December 2013 found that the majority of firms (62%) in a sample of 26, used a limit at 5% of materiality (£950,000 for Cambridgeshire County Council) but were more flexible in its use across different disclosures, implementing 2% where necessary.
- 1.5 An increase in the limit would bring Cambridgeshire County Council in line with other authorities of a similar size audited by PricewaterhouseCoopers (see Appendix 1).

## **2.0 OPTIONS**

- 2.1 While there are three options identified herein, there is scope to choose other levels.
- 2.2 The options discussed within this paper are as follows:
  - Retaining the £250,000 ‘clearly trivial’ limit used previously
  - Raising the ‘clearly trivial limit’ to £500,000
  - Raising the ‘clearly trivial limit’ to £950,000 (the maximum permissible by the external auditors)

## **3.0 ADVANTAGES OF RAISING THE TRIVIALITY THRESHOLD**

- 3.1 There are several clear benefits to both Cambridgeshire County Council and the external auditors to raising the ‘clearly trivial’ threshold:
- 3.2 Advantages for the Council:
  - There would be a potential reduction in external audit costs to the Council due to the lower amount of secondary testing and feedback required.
  - All areas of control weakness found in the 2013/14 audit and included in the ISA260 would still have been identified. This would have been the case for both a £500,000 and £950,000 limit.

- All areas that were tested previously would still be tested. A raised 'triviality limit' will only reduce the number of areas where further testing is required.
- Extrapolation techniques employed by the auditors are less likely to result in entries on the ISA260 report – in the 2013/14 ISA260, one £61 error found in the testing of schools' expenditure was extrapolated across the population of schools' expenditure, resulting in the identification of an additional misstatement of £354k.

### 3.3 Advantages for the External Auditors:

- There would be a reduction in the number of areas that require additional testing, reducing the amount of time required for the external audit, or releasing resources to perform more substantive testing on more critical areas.
- There would also be a reduction in the amount of testing of smaller items, as more balances are removed from the scope of the audit.
- It is likely that the number of areas that require some discussion to determine whether or not there is an issue that needs to be taken forward for further discussion around inclusion within the ISA260 will fall.

## 4.0 DISADVANTAGES OF RAISING THE TRIVIALITY THRESHOLD

4.1 There are also some potential minor disadvantages to raising the triviality threshold.

4.2 Disadvantages for the Council:

- For the £950,000 limit, this is very close to the £1,000,000 cap the external auditors have in place for all local authorities due to their requirements for Whole of Government Accounts reporting. The National Audit Office sets this level, and it is subject to change, so a reduction to below the limit set would lead to the external auditors having to revisit completed work.
- There would be a potential reduction in the level of assurance on financial controls for smaller transactions
- The higher the agreed threshold, the higher the likelihood that this will be rejected by the Audit Commission

4.3 Disadvantages for the external auditors:

- There would be a change in procedures, and so the external auditors would need to reassess the amount of additional testing they would need to do in each area. The level of testing around system controls would not be reduced.

## 5.0 RECOMMENDATION

5.1 Following discussion with PricewaterhouseCoopers, it is recommended that raising the triviality limit to £500,000 (an amount lower than the maximum allowable) would be likely to provide benefits to both Cambridgeshire County Council due to potential cost reductions, and to external audit, due to a reduction in required secondary testing.

5.2 Raising the triviality limit to £500,000 would raise the limit to 2.6% of the overall materiality limit, which would still remain a relatively low level in comparison to other local authorities.

## **6.0 ALIGNMENT WITH CORPORATE PRIORITIES**

### **6.1 Developing the local economy for the benefit of all**

There are no significant implications for this priority.

### **6.2 Helping people live healthy and independent lives**

There are no significant implications for this priority.

### **6.3 Supporting and protecting vulnerable people**

There are no significant implications for this priority.

## **7.0 SIGNIFICANT IMPLICATIONS**

### **7.1 Resource Implications**

There are no significant implications within this category.

### **7.2 Statutory, Risk and Legal Implications**

There are no significant implications within this category.

### **7.3 Equality and Diversity Implications**

There are no significant implications within this category.

### **7.4 Engagement and Consultation Implications**

There are no significant implications within this category.

### **7.5 Localism and Local Member Involvement**

There are no significant implications within this category.

### **7.6 Public Health Implications**

There are no significant implications within this category.

<u>Source Documents</u>	<u>Location</u>
<a href="https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Materiality.pdf">https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Materiality.pdf</a>	

**Appendix 1 – Comparison to other Local Authorities in 2013/14 (including materiality and overall expenditure levels)**

<b>Authority*</b>	<b>Overall materiality</b>	<b>Clearly trivial de minimis level</b>	<b>Triviality as a % of materiality</b>
Cambridgeshire County Council	£19,000,000	£250,000	1.3%
Peterborough City Council	£10,225,520	£350,000	3.4%
Staffordshire County Council	£13,900,000	£700,000	5.0%
Wolverhampton City Council	£13,800,000	£700,000	5.0%
Newham Borough Council	£11,300,000	£500,000	4.4%
Newham Borough Council Pension Fund	£9,000,000	£250,000	2.8%
Redbridge Borough Council	£16,400,000	£500,000	3.0%
Redbridge Borough Council Pension Fund	£10,675,000	£500,000	4.7%
Huntingdonshire District Council	£1,828,000	£90,000	4.9%

\*The authorities chosen have been done so as a result of being audited by PricewaterhouseCoopers, and so have materiality and triviality information readily available.