Derby City Council
Audit planning report

Year ended 31 March 2021

July 2021

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12th July 2021

Derby City Council
Council House
Corporation Street
Derby
DE1 2FS

Dear Audit and Accounts 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 and Accounts 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 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the 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 and Accounts 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 28 July 2021, as well as understand whether there are other matters which you consider may influence our audit.

Helen Henshaw

Yours faithfully,

Helen Henshaw

For and on behalf of Ernst & Young LLP

Contents

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 and Accounts Committee and management of Derby City Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit and Accounts Committee and Management of Derby City 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 and Accounts Committee and Management of Derby City 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 and Accounts 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
Risk of fraud in revenue and expenditure recognition for year end accruals, capitalisation of revenue expenditure and the recognition and treatment of the additional grants received in year for Covid-19.	Fraud risk	Change in focus	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 believe the risk is focused on: ▸ year-end balance sheet positions, in particular the existence of accrued income and existence of expenditure accruals; ▸ the potential to incorrectly capitalise revenue expenditure; and ▸ the recognition and treatment of the addition grants received in year for Covid-19. Further details are provided at page 10.
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. Further details are provided at page 11.
Valuation of Land and Buildings	Higher inherent risk	Change in risk and focus	Property, Plant and Equipment accounts for a significant proportion of the Council's total assets. The valuation process incorporates significant judgements, which if inappropriate could result in a material misstatement. We consider a higher inherent risk over the assets valued at fair value (Other land and buildings (£95m), Surplus assets (£15m) and Council Dwellings (£522m)). The remainder assets valued at historic cost and depreciated replacement costs (DRC) are considered to be lower inherent risk. (Other land and buildings valued at DRC (£245m) for example schools, vehicle plant equipment (£15m), infrastructure assets (£272m), community asset (£2m) and assets under construction (£49m). Note - figures quoted from draft unaudited statement of accounts for 2020/21. Further details are provided at page 12.

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 and Accounts 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
PFI Financing	Higher inherent risk	No change in risk or focus from	The Council has a number of assets held under PFI arrangements. Four of these are recorded on the Council's balance sheet, one is not. Such arrangements are complex and substantial in value and there is a risk that disclosures in the financial statements are not consistent with the PFI operating model. Further details are provided at page 13.
Valuation of Local Government Pension Scheme (LGPS) Liability	Higher inherent risk	No change in risk or focus	The Council is a member of the Local Government Pension Scheme (LGPS), administered by Derbyshire Pension Fund. The net pension liability from the draft accounts as at 31 March 2021 was £442 million. The estimation of the defined benefit obligations is sensitive to a range of assumptions such as rates of pay and pension inflation, mortality and discount rates. The pension fund valuations separately involve external specialists, to provide these actuarial assumptions. A small movement in these assumptions could have a material impact on the value in the balance sheet. Further details are provided at page 13.
Accounting for SinFin Waste Plant	Higher inherent risk	No change in risk or focus	Derby City Council and Derbyshire County Council contracted with Resource Recovery Solutions Derbyshire (RRS) to manage the Sinfin Waste Plant. The waste treatment centre was due to open in Sinfin in 2017, but RRS has been unable to resolve ongoing issues that would allow the facility to pass the certified performance tests required to bring it into full service. In April 2019, the two councils issued a formal notice to the project's funders to take action under the contract to progress the project. The agreement with RRS to manage the Sinfin Waste Plant was cancelled in August 2019 when the banks funding the project issued a legal notice. There is a risk that any associated transactions are not accurately accounted for in the financial statements. Further details of the risk are provided at page 1.

Overview of our 2020/21 audit strategy

Materiality

Planning materiality

Materiality has been set at 1% of the current years gross expenditure on provision of services (adjusted to include Housing Capital Receipts Pool payments and Interest Payable) consistent with prior years.

Performance materiality

Performance materiality has been set at 75% of materiality.

Audit differences

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, and pension fund financial statements) greater than the defined level. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit and Accounts Committee.

Entity	Basis of materiality	Planning materiality	Performance materiality	Audit differences
Group	Gross revenue expenditure	£6.4m	£4.8m	£0.3m
The Council	Gross revenue expenditure	£6.5m	£4.8m	£0.3m

Further details of how performance materiality has been calculated is at page 22.

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 Derby City 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 conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the 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 and 15 in recent years as well as the expansion of factors impacting the value for money conclusion. The extent of these or any other risks relevant in the context of Derby City Council's audit, have been discussed with management as to the impact on the scale fee, for further details please see Appendix A.

There have been changes to the Value for Money approach in 2020/21, there will be the need for additional work. We have set out below where we believe there is the potential to give rise to additional fee. We will discuss with management during the audit and report back to the Audit Committee.

- The 2020 Code has changed the scope of the value for money assessment and work required.
- Additional work that will be required to address the value for money risks if identified from the risk assessment

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.

***Risk of fraud in revenue and expenditure recognition for year end accruals, capitalisation of revenue expenditure and the recognition and treatment of the additional grants received in year for Covid-19.**

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.

Having considered the factors for income and expenditure recognition, we believe the risk:

- is focused on year-end balance sheet and in particular the existence of accrued income and existence of expenditure accruals.
- is linked to the potential to incorrectly capitalise revenue expenditure.
- is present in the recognition and treatment of the addition grants received in year for Covid-19.

Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts.

What will we do?

We will:

- Review and test expenditure recognition policies to ensure that they are in line with accounting guidelines and adhered to correctly.
- Review and discuss with management any accounting estimates on expenditure recognition for evidence of bias.
- Develop a testing strategy to test the existence of material accrued income and expenditure accruals.
- Sample test additions to property, plant and equipment to test whether the Council has inappropriately capitalised revenue expenditure.
- Sample test the revenue and capital Covid-19 grants received by the Council to ensure the accounting treatment and recognition applied to grant income is appropriate.

Our response to significant risks (continued)

*Misstatements due to fraud or error	What is the risk?	What will we do?
	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.	▸ Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; ▸ Review and discuss with management any changes the methodologies of existing and new accounting estimates for evidence of bias; ▸ Enquire of management about risks of fraud and the controls put in place to address those risks; ▸ Evaluate the business rationale for significant unusual transactions; and ▸ Understand the oversight given by those charged with governance of management's processes over fraud.

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
<u>Valuation of Land and Buildings</u> Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances 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 valuation process incorporates significant judgements, which if inappropriate could result in a material misstatement to the financial statements. We consider there to be a higher inherent risk over the assets valued at fair value tied to market movements (Other land and buildings (£104m), Surplus assets (£15m) and Council Dwellings (£522m)). The remainder of the assets, valued at historic cost and depreciated replacement costs (DRC) are considered to be lower inherent risk. Other land and buildings valued at DRC (£236m) which includes schools and other specialised assets are considered lower inherent risk because the reason the Council holds these assets is to facilitate service delivery. Valuation of these assets do not impact the Council's reported outturn position or decision making in respect of future income streams. Vehicle plant equipment (£15m), infrastructure assets (£272m), community asset (£2m) and assets under construction (£49m) are valued at historic cost and therefore not subject to revaluation and consequential valuation estimation uncertainty. **Note - figures quoted from draft unaudited statement of accounts for 2020/21.** The Council has rolling valuation process, which annually values 20% of the land and building assets, is subject to a number of assumptions and judgements, which if inappropriate could result in a material impact on the financial statements. There is also a potential risk of material misstatement that the remaining 80% of unvalued assets may have experienced a material change in value which has not been identified and accounted for correctly.	We will; ▸ Document our understanding of the processes and controls in place to mitigate the risks identified, and walk through those processes and controls to confirm our understanding; ▸ Evaluate the competence, capabilities and objectivity of management's specialist; ▸ Review any terms of engagement or instructions issued to the valuer to ensure these are consistent with accounting standards. And assess if the instruction includes a specific instruction from the council to the valuer relating to an assessment on the unvalued population; ▸ Engage our valuation specialists to support our testing strategy and help evaluate the work of the Council's valuer; ▸ Review the classification of assets and ensure an appropriate valuation methodology has been applied; ▸ Ensure the valuer's conclusions have been appropriately recorded in the accounts; and ▸ Review the assets not formally revalued in the year to ensure that Management have appropriately taken into account the potential for material movement in value to have occurred since the last formal valuation date.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
PFI Financing The Council has a number of assets held under PFI arrangements. Four of these are recorded on the Council's balance sheet, one is not. Such arrangements are complex and substantial in value.	Our approach will focus on: ▸ Obtaining and documenting an understanding of the schemes; ▸ Considering whether the scheme falls within IFRIC 12 and should be accounted for on balance sheet; ▸ Ensuring the outputs from the accounting model are correctly reflected in the financial statements, and relevant disclosures have been made; and ▸ Considering the impact of Covid-19 on the financial stability of providers.
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 administered by Derbyshire County Council. 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. At 31 March 2021 this totalled £442 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. 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.	We will: ▸ Liaise with the auditors of Derbyshire Pension Fund to obtain assurances over the information supplied to the actuary in relation to Derby City Council; ▸ Assess the work of the Pension Fund actuary (Hymans) 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. We will consider outturn information available at the time we undertake our work after production of the Council's draft financial statements, for example the year-end actual valuation of pension fund assets. We will use this to inform our assessment of the accuracy of estimated information included in the financial statements and whether any adjustments are required.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Accounting for SinFIn Waste Plant Derby City Council and Derbyshire County Council contracted with Resource Recovery Solutions Derbyshire (RRS) to manage the Sinfin Waste Plant. The waste treatment centre was due to open in Sinfin in 2017, but RRS has been unable to resolve ongoing issues that would allow the facility to pass the certified performance tests required to bring it into full service. In April 2019, the two councils issued a formal notice to the project's funders to take action under the contract to progress the project. The agreement with RRS to manage the Sinfin Waste Plant was cancelled in August 2019 when the banks funding the project issued a legal notice. There is a risk that any associated transactions are not accurately accounted for in the financial statements.	Our approach will focus on: ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to Waste Plant. ▸ Consider the recoverability of the £5.6m held on the Council's balance sheet (as asset under construction) which relates to the Sinfin Waste Plant.

03 Value for Money Risks

Value for Money

Derby City Council's responsibilities for value for money

Derby City Council are 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.

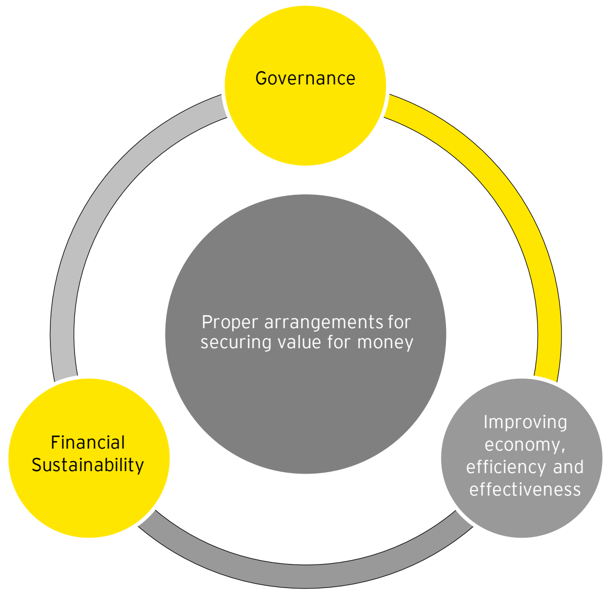
As part of the material published with its financial statements, Derby City Council are required to bring together commentary on its governance framework and how this has operated during the period in a governance statement. In preparing its governance statement, the organisation tailor's the content 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 organisation 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 which we need to conclude on. Instead the 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the organisation a commentary against specified reporting criteria (see below) on the arrangements the organisation 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 organisation plans and manages its resources to ensure it can continue to deliver its services;
- **Governance**
  How the organisation ensures that it makes informed decisions and properly manages its risks; and
- **Improving economy, efficiency and effectiveness**
  How the organisation 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 Derby City 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 considering the bodies arrangements, we are required to consider:

- Derby City Council's governance statement;
- Evidence that the Derby City Council's arrangements were in place during the reporting period;
- Evidence obtained from our work on the accounts;
- The work of inspectorates and other bodies and;
- Any other evidence source that we regard as necessary to facilitate the performance of our statutory duties.

We then consider whether there is evidence to suggest that there are significant weaknesses in arrangements. The NAO's guidance is clear that the assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement. However, the NAO states that a weakness may be said to be significant if it:

- Exposes – or could reasonably be expected to expose – Derby City Council to significant financial loss or risk;
- Leads to – or could reasonably be expected to lead to – significant impact on the quality or effectiveness of service or on Derby City Council's reputation;
- Leads to – or could reasonably be expected to lead to – unlawful actions; or
- Identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

We should also be informed by a consideration of:

- The magnitude of the issue in relation to the size of Derby City Council;
- Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves (where applicable), or impact on budgets or cashflow forecasts;
- The impact of the weakness on Derby City Council's reported performance;
- Whether the issue has been identified by the Derby City Council's own internal arrangements and what corrective action has been taken or planned;
- Whether any legal judgements have been made including judicial review;
- Whether there has been any intervention by a regulator or Secretary of State;
- Whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- The impact on delivery of services to local taxpayers; and
- The length of time the organisation has had to respond to the issue.

Value for Money Risks

Responding to identified risks

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.

Reporting on VFM

In addition to the commentary on arrangements, where we are not satisfied that Derby City Council have made proper arrangements for securing economy, efficiency and effectiveness in its use of resources the 2020 Code has the same requirement as the 2015 Code in that we should refer to this by exception in the audit report on the financial statements.

However, a new requirement under the 2020 Code is for us to include the commentary on arrangements in a new Auditor's Annual Report. The 2020 Code states that the commentary should be clear, readily understandable and highlight any issues we wish to draw to the organisation's attention or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with our view as to whether they have been implemented satisfactorily.

Status of our 2020/21 VFM planning

We have recently started our VFM assessment. In line with the 2020 Code, we will inform the committee if we identify any significant weaknesses in the Council's arrangements.

As part of our risk assessment we will follow up the risks identified in 2019/20 as summarised on the following page.

Value for Money Risks

What is the value for money risk?	What arrangements does the risk affect?	What will we do?
Improving economy, efficiency and effectiveness – follow up from 2019/20	<u>Results of regulatory reviews and commentary</u> During June 2019, Ofsted and the Care Quality Commission (CQC) conducted a joint inspection of the local Derby area to judge the effectiveness of the area in implementing the disability and special educational needs (SEND) reforms. The inspection raised significant concerns about the effectiveness of the local area and a written statement of action to Ofsted that explains how the local area will tackle the following areas of significant weakness was submitted: ▸ failure of the local area to take the joint commissioning actions required to implement the reforms across education, health and social care; ▸ lack of an overarching coproduced strategy for improving provision for and outcomes of children and young people with SEND; ▸ number of significant weaknesses in the EHC processes, timeliness, quality and outcomes of plans; ▸ long-standing systemic issues with waiting times to access a large number of key services; ▸ poor parental engagement with plans for local area SEND provision and high levels of parental dissatisfaction. On review of the significant weaknesses highlighted by the report we concluded that the Authority's arrangement, to work effectively with partners to deliver required services and outcomes to the local population specifically over SEND, were not in place throughout 2019/20 and a qualified 'except-for' conclusion will be issued. As part of our VFM commentary in 2020/21, we will review the progress made against the detailed plans within the written statement of action to the inspectorate, to address the significant weaknesses highlighted by the report.	We will focus on: ▸ Updating our understanding of progress made against the written statement to the inspectorate; and ▸ Discussing with Officers the actions taken and future plans to address the areas of weakness in the joint report.

Value for Money Risks

What is the value for money risk?	What arrangements does the risk affect?	What will we do?
Financial sustainability – follow up from 2019/20	The 2020/21 budget set of £238m in February 2020 showed the Authority will be using reserves of £2.8m, to balance the budget, and a savings requirement of £4.7m. The budget was refreshed following the outbreak of Covid-19 at Quarter 1 (20/21). At that time the forecast was an overspend of £8.3m and there was an expectation that £2.9m savings would be delivered. The draft outturn position for 2020/21 shows an underspend of £1.8m, which was transferred to the budget risk reserve and savings of £4.7m were delivered. To achieve a balanced budget for 2021/22 there is a requirement to make new savings of £7.4m and to use £1.9m in reserves. The MTFP for 2021/22 further highlights gaps of £11.2m and £13.7m in 2022/23 and 2023/24.	We will focus on: ▸ Understanding and reviewing the Council's arrangements for ensuring financial sustainability.
Improving economy, efficiency and effectiveness – follow up from 2019/20	<u>Capital projects</u> The Council has experienced significant overspends in capital projects over recent years. We will review the Council's capital programme, focusing on key on going projects and those concluding in 2021/22. Projects concluded in 2021/22 include Moorways Leisure Centre and the A52 improvement project. Other key projects include Assembly rooms, Market Hall and Sinfin Waste plant.	Our approach will focus on: ▸ Identifying the processes installed in relation to the monitoring of capital projects and the process for capital budget monitoring and approval requirements for increased cost commitment for capital projects. ▸ Monitor the progress and delivery of the key capital projects.

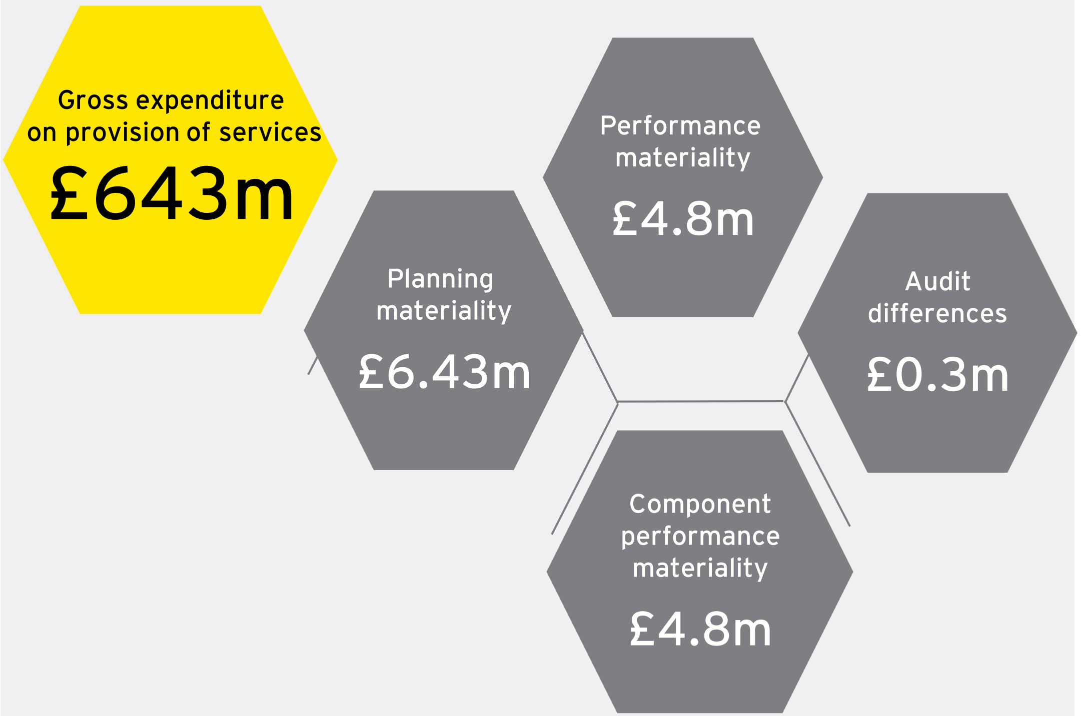
04 Audit materiality

Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2020/21 has been set at £6.4m for the Group and £6.5m for the Council. This represents 1% of the current year gross expenditure on the provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



We request that the Audit and Accounts 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 £4.8m which represents 75% of planning materiality.

Component performance materiality range – we determine component performance materiality as a percentage of Group performance materiality based on risk and relative size to the Group.

We have allocated performance materiality as follows:

- Derby City Council (as stand alone entity) £4.8m
- Derby Homes Limited £0.97m

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. The same threshold for misstatements is used for component reporting. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, housing revenue account, collection fund financial statements that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Audit and Accounts Committee, or are important from a qualitative perspective.

Specific materiality – We will set a lower materiality 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 this.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the 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.

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 plan, where they raise issues that could have an impact on the financial statements.

Scoping the group audit

Group scoping

Our audit strategy for performing an audit of an entity with multiple locations is risk based. We identify components as:

1. **Significant components:** A component is significant when it is likely to include risks of material misstatement of the group financial statements, either because of its relative financial size to the group (quantitative criteria), or because of its specific nature or circumstances (qualitative criteria). We generally assign significant components a full or specific scope given their importance to the financial statements.
2. **Not significant components:** The number of additional components and extent of procedures performed depended primarily on: evidence from significant components, the effectiveness of group wide controls and the results of analytical procedures.

For all other components we perform other procedures to confirm that there is no risk of material misstatement within those locations. These procedures are detailed below.

Scoping by Entity

Our preliminary audit scopes by number of locations we have adopted are set out below.

2	A	Full scope audits
0	B	Specific scope audits
0	C	Review scope audits
0	D	Specified procedures
0	E	Other procedures

Both Derby City Council (stand alone entity) and Derby Homes Limited are considered to be full scope audits based on size.

Scope definitions

Full scope: locations where a full audit is performed to the materiality levels assigned by the Group audit team for purposes of the consolidated audit. Procedures performed at full scope locations support an interoffice conclusion on the reporting package. These may not be sufficient to issue a stand-alone audit opinion on the local statutory financial statements because of the materiality used and any additional procedures required to comply with local laws and regulations.

Specific scope: locations where the audit is limited to specific accounts or disclosures identified by the Group audit team based on the size and/or risk profile of those accounts.

Review scope: locations where procedures primarily consist of analytical procedures and inquiries of management. On-site or desk top reviews may be performed, according to our assessment of risk and the availability of information centrally.

Specified Procedures: locations where the component team performs procedures specified by the Group audit team in order to respond to a risk identified.

Other procedures: For those locations that we do not consider material to the Group financial statements in terms of size relative to the Group and risk, we perform other procedures to confirm that there is no risk of material misstatement within those locations. Individually, these components do not exceed more than 1% of the Group's Deficit on the provision of services.

Scoping the group audit (continued)

Group audit team involvement in component audits

Auditing standards require us to be involved in the work of our component teams.

The same EY audit team perform the audit of the Council as a stand-alone entity, and the consolidated Group accounts.

BDO LLP audit the statutory accounts of the Council's subsidiary, Derby Homes Limited. BDO LLP have confirmed their independence to EY as the primary auditor of the Derby City Council group.

Our involvement in the audit of Derby Homes Limited will be as follows:

- Planning meeting with BDO LLP by conference call
- Group audit instructions issued to BDO LLP
- Questionnaire issued to BDO LLP to assist in EY assessment of the work performed
- Closing meeting with BDO LLP by conference call
- Review of BDO LLP reporting documentation and key working papers

06 Audit team

Audit team

The engagement team is led by Helen Henshaw, who has significant experience of Local Government audits. Helen is supported by Vishal Savjani, a Senior Manager who is responsible for the day-to-day direction of audit work and is the key point of contact for the Director of Financial Services.

Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	EY Valuations Team
Pensions disclosure	EY Actuaries
PFI	EY PFI specialist

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

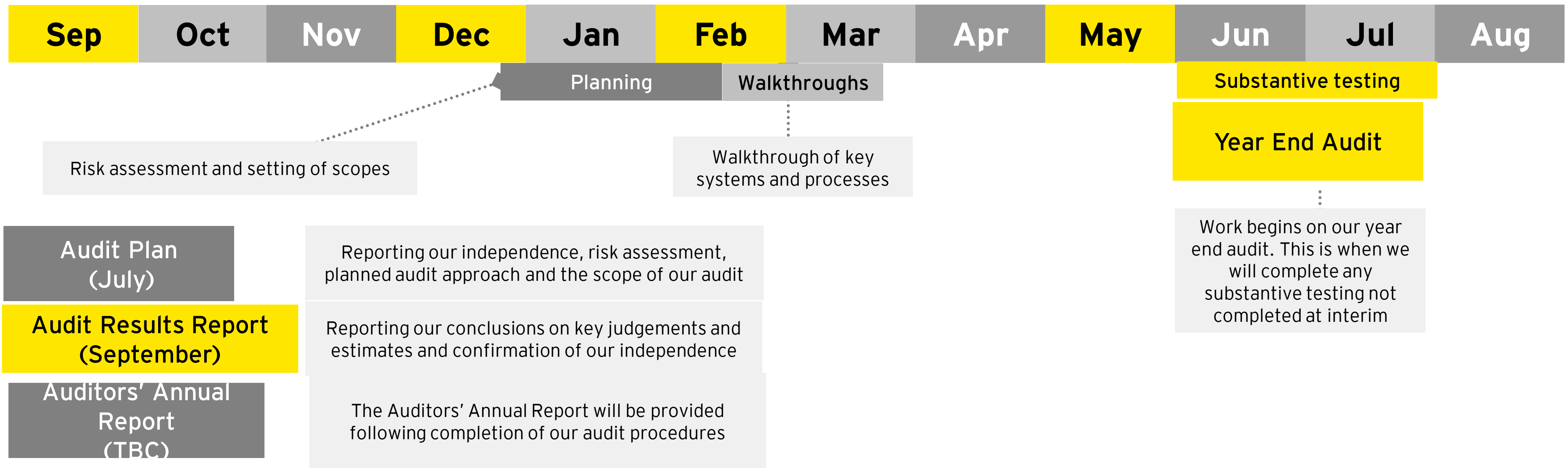
Timetable of communication and deliverables

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 and Accounts Committee and we will discuss them with the Audit and Accounts Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Please note:
We have been informed by the Derbyshire Pension Fund auditor, that they expect to be able to provide the IAS19 assurances by the end of August. We are not able to conclude our audit until we have considered the results of the IAS19 assurances.



08 Independence

Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
► The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us; ► 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. ► Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard [note: additional wording should be included in the communication reflecting the client specific situation]	► In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ► 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; ► Written confirmation that all covered persons are independent; ► 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 any contingent fee arrangements for non-audit services provided by us or our network firms; 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 also provide information on any contingent fee arrangements , the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

Relationships, services and related threats and safeguards

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 Henshaw, 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, the current ratio of non-audit fees to audit fees is approximately 12%. No additional safeguards are required.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

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

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the 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.

Other threats

Other threats, such as advocacy, familiarity 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 end 30 June 2020: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2020/ey-uk-2020-transparency-report.pdf

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
	£	£	£
Total Fee - Code work	109,766	109,766	109,766
Additional audit fee (scale fee variation to rebase the scale fee to a sustainable level) see Note 1	138,869	0	138,869
Additional audit fee (additional costs incurred specific to the current year audit) see Note 2	TBC	0	64,813
Total audit	264,883	109,766	313,448
Housing Benefit Subsidy Claim	20,846	0	20.846
Teacher's Pension Audit	6,500	0	6,500
Pooling of Housing Capital Receipts	5,000	0	5,000
Total other non-audit services	32,346	0	32,346
Total fees (exclude VAT)	280,981	109,766	345,794

(Note 1) As per the Redmond Report, local government external audit fees have not kept pace with regulatory change. We believe that changes in the work required to address professional and regulatory requirements and scope changes associated with the risk of the organisation mean that the scale fee for the Group should more realistically be set at a level of £248,635. The scale fee is set by PSAA Limited. The Council does not agree with our assessment.

(Note 2)

2019/20 - We have discussed the scale fee variation with management and it is subject to approval by PSAA Limited. The Council does not fully agree with our assessment.

2020/21 – The results of our planning procedures has identified areas where audit work will be required over and above the level of the fee previously set which also correspond to the risks set out in our audit plan. The identified areas are:

- PPE valuations (use of specialists);
- Group accounts;
- Grant received in regards of Covid 19
- Value for Money - The 2020 Code has changed the scope of the value for money assessment and work required. This could result in additional fees. Also, there may be additional work that will be required to address the value for money risks, if identified from the risk assessment.

We will discuss these with management and provided indicative fee levels for each of these areas. The actual amounts may differ and will be based on the actual audit effort incurred. Following discussions with management we have not included these amounts in this plan but will report the final levels to you upon conclusion of our work and agreement with management

The agreed fee presented is based on the following assumptions:

Officers meeting the agreed timetable of deliverables; Our accounts opinion and value for money conclusion being unqualified; Appropriate quality of documentation is provided by the entity; and the entity has an effective control environment.
If you are unable to meet key dates within our agreed timetable, we will notify you of the impact on the timing of your audit, which may be that we postpone your audit until later in the summer and redeploy the team to other work to meet deadlines elsewhere.

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

Required communications	What is reported?	Our Reporting to you When and where
Terms of engagement	Confirmation by the Audit and Accounts 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 – date to be confirmed

Appendix B

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 – date to be confirmed
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 – date to be confirmed
Fraud	▸ Enquiries of the Audit and Accounts 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 – date to be confirmed
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 – date to be confirmed

Appendix B

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 – date to be confirmed
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report – date to be confirmed
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report – date to be confirmed
Auditors report	▶ Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report – date to be confirmed
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 – date to be confirmed

Appendix B

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report - date to be confirmed
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 Audit Committee may be aware of	Audit Results Report - date to be confirmed
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit Results Report - date to be confirmed
Group audits	▸ An overview of the type of work to be performed on the financial information of the components ▸ An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ▸ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ▸ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ▸ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Audit Planning Report July 2021 Audit Results Report - date to be confirmed

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. ▸ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the **Audit Committee** reporting appropriately addresses matters communicated by us to the **Audit Committee** and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▸ Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the Group financial statements; and
- 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.