

Derby City Council

Year ending 31 March 2016

Audit Plan

23 March 2016

Ernst & Young LLP



EY

Building a better
working world

Members of the Audit & Accounts Committee
Derby City Council
The Council House
Corporation Street
Derby
DE1 2FS

14 March 2016

Dear Committee Members

Audit Plan

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 & Accounts Committee with a basis to review our proposed audit approach and scope for the 2015/16 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.

We welcome the opportunity to discuss this Audit Plan with you on 23 March 2016 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Steve Clark
Partner
For and behalf of Ernst & Young LLP
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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued “Statement of responsibilities of auditors and audited bodies 2015-16”. It is available from the Chief Executive of each audited body and via the [PSAA website \(www.psa.co.uk\)](http://www.psa.co.uk)

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 from 1 April 2015’ issued by 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 statute, and covers matters of practice and procedure which are of a recurring nature.

This Audit Plan is prepared in the context of the Statement of responsibilities. It is addressed to the Audit & Accounts Committee, and is prepared for the sole use of the audited body. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

1. Overview

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 2016 and of the income and expenditure for the year then ended;
- ▶ 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.

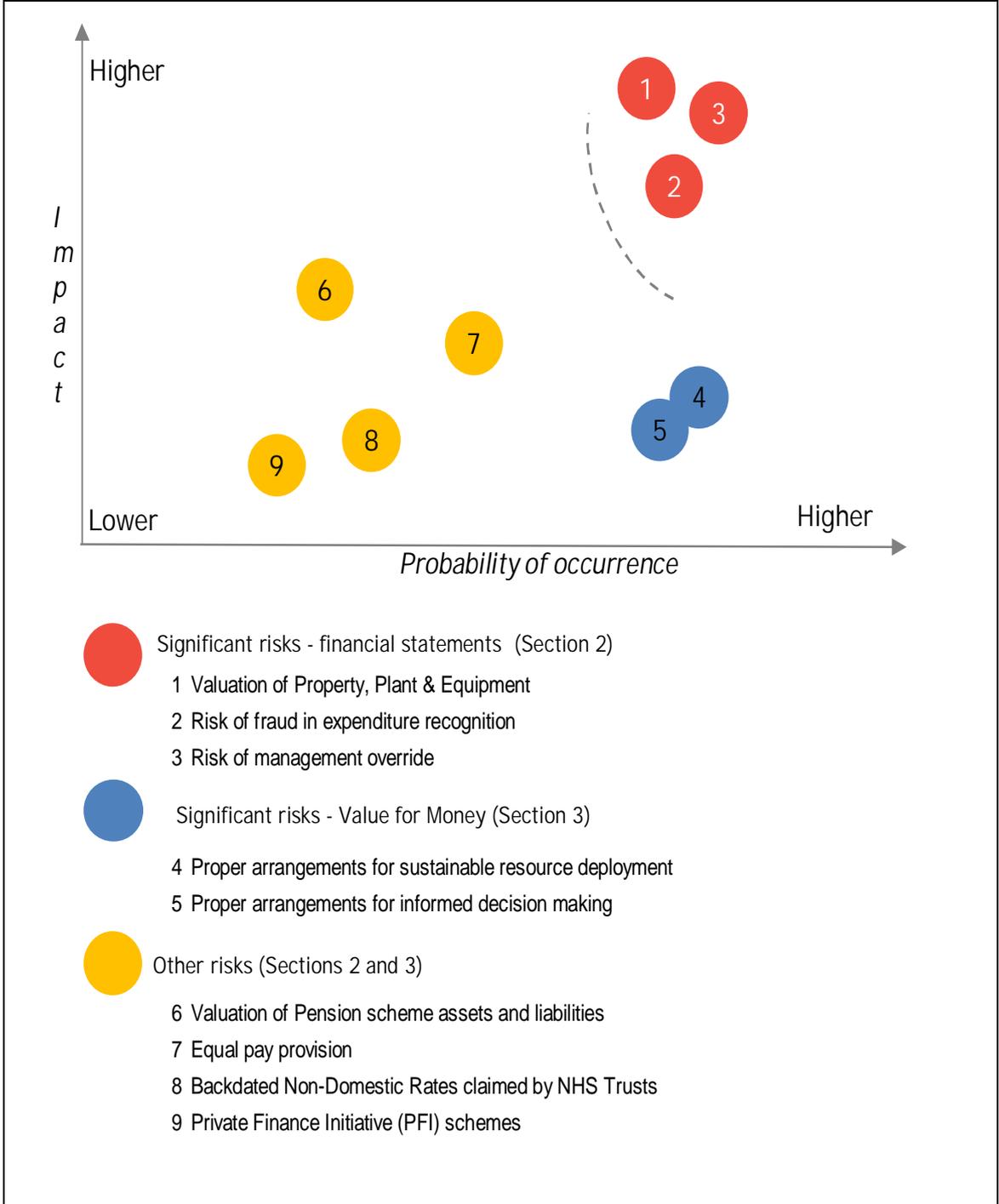
By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

We analyse the risks inherent in your external influences, operational activities and financial risks for the Council and our knowledge of other factors that may impact the Council's financial statements. At our meeting, we will seek to validate these with you:

External influences	The Council
<p>Economic</p> <ul style="list-style-type: none"> ▶ Increasing demand on services ▶ Continuing pressure on funding and delivering efficiencies within an increasingly challenged public sector economy <p>Environmental and social</p> <ul style="list-style-type: none"> ▶ Reputational risks relating to services ▶ Flood defences ▶ Tackling health inequalities <p>Regulation</p> <ul style="list-style-type: none"> ▶ OFSTED, CQC, Health & Safety Executive and to a lesser extent guidance from CIPFA and the LGA 	<p>Strategy</p> <ul style="list-style-type: none"> ▶ A new relationship with communities and citizens, with local people doing more for themselves and each other ▶ Continued focus on using minimal resources well, and making sure that every pound and hour, is productive ▶ Greater collaboration with public sector partners, businesses and community organisations to connect ideas, people and resources <p>People</p> <ul style="list-style-type: none"> ▶ Building a modern, flexible and emotionally intelligent workforce ▶ Implementation of the Job Evaluation review
Operational	Finance
<p>Operational excellence</p> <ul style="list-style-type: none"> ▶ Maintaining effective quality, performance and financial governance ▶ Delivering, procuring and commissioning quality services and delivering positive outcomes 	<p>Process</p> <ul style="list-style-type: none"> ▶ Effective internal control environment ▶ Sustainable financial plans ▶ Consolidation of Derby Homes Limited <p>Balance sheet</p> <ul style="list-style-type: none"> ▶ Recognition and measurement of receivables, payables and accruals ▶ Valuation of Property, Plant and Equipment ▶ Valuation of the Pension Fund Asset and Liability

This risk assessment process will help inform the focus our audit work for the year ending 31 March 2016.

The following 'dashboard' summarises the significant matters that are relevant for planning our audit. More information about each of these risks, and our proposed response, is provided in sections two and three of this report.



Changes in audit scope

2015/16 represents the first year of appointment for EY as the Council's external auditor.

As part of the transition from our predecessor, Grant Thornton, we review the external auditor reports and supporting workpapers for the previous year (ie 2014/15).

As a result of these transition procedures, we note the following change in audit scope for the 2015/16 financial year:

- ▶ Derby Homes Limited will be included in the group audit as a full scope component audit due to the size of the balances within Derby Homes Limited relative to the group materiality level.

Appendix C provides an overview of the nature of our planned involvement in the work to be performed by the component auditors of Derby Homes Limited.

We will provide an update to the Audit & Accounts Committee on the results of our work in this area in our report to those charged with governance scheduled for delivery in September 2016.

2. Financial statement risks

We outline below our current assessment of the financial statement risks facing the Council identified through our knowledge of the Council's operations and discussion with those charged with governance and officers.

At our meeting, we will seek to validate these with you.

Significant risks (including fraud risks)	Our audit approach
<p>Valuation of property, plant and equipment</p> <p>Land and buildings is the most significant balance in the Council's Statement of Financial Position.</p> <p>The valuation of land and buildings is subject to a number of assumptions and judgements and even a small movement in these assumptions, could have a material impact on the accounts.</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Using our EY valuation specialists to: <ul style="list-style-type: none"> ▶ Understand and assess the process that the Council undertakes when valuing its land and buildings, and the controls in place ▶ Review (on a sample basis) the output of the Council's valuer ▶ Challenging the assumptions used by the Council's valuer by reference to external evidence and our EY valuation experts ▶ Testing the journals for the valuation adjustments to check that they have been accurately processed in the accounts
<p>Risk of fraud in expenditure recognition*</p> <p>Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue.</p> <p>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.</p> <ul style="list-style-type: none"> ▶ For Derby City Council we consider that this risk presents itself in other service expenses. 	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Review and testing of revenue and expenditure recognition policies ▶ Review and discussing with management any accounting estimates on revenue or expenditure recognition for evidence of bias ▶ Developing a testing strategy to test material revenue and expenditure streams ▶ Review and testing revenue cut-off at the period end date ▶ Performing unrecorded liabilities testing
<p>Risk of management override*</p> <p>As identified in ISA (UK and Ireland) 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.</p> <p>For Derby City Council we consider that this risk presents itself in:</p> <ul style="list-style-type: none"> ▶ the risk of inappropriate capitalisation of revenue expenditure ▶ the determination of accounting estimates ▶ the posting of manual journals to the general ledger 	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements ▶ Reviewing accounting estimates for evidence of management bias, and ▶ Evaluating the business rationale for significant unusual transactions

* As defined by auditing standards

Other financial statement risks

Valuation of Pension scheme assets and liabilities

Funding of the Council's participation in the local government pension scheme will continue to have an impact on both Council cash flows and balance sheet liabilities.

The pension liability is the most significant liability on the Council's balance sheet and is calculated through use of a number of actuarial assumptions. A small movement in these assumptions could have a material impact on the balance sheet.

Our approach will focus on:

- ▶ Reviewing the output of the report from the Administering Council's actuary
- ▶ Reviewing the assumptions used by the actuary to determine whether they are in our expected range
- ▶ Testing the journal entries for the pensions transactions to check that they have been accurately processed in the accounts

Equal Pay Provision

The Council's Equal Pay liability is a continuing challenge with £13 million included in the 2014/15 accounts which incorporated unpaid claims received to 31 March 2015 and an estimate of future claims. The timing of potential claims is dependent on the timing and volume of appeals lodged against the Council. There is a potential for an increase in claims after implementation of the revised Job Evaluation review, scheduled for 1 June 2016.

Our approach will focus on:

- ▶ Review of claims received and settled in the financial year
- ▶ Challenge of the assumptions used by management when determining its estimate of future claims
- ▶ Review of any legal advice obtained by the Council with reference to the risks of litigation posed by the implementation of the Job Evaluation review.

Backdated Non-Domestic Rates claims by NHS Trusts

The sector is subject to an emerging issue with respect to NHS Trusts and Foundation Trusts lodging applications to their Local Authority to claim backdated relief on the Non-Domestic Rates paid.

The Council is in receipt of such applications.

The likelihood and value of any possible settlement is unknown, and due to the scale of the issue, is unlikely to be known for some considerable time as test cases are put before the Courts.

Our approach will focus on:

- ▶ Review of claims received by the Council
- ▶ Review of any legal advice obtained by the Council
- ▶ Challenging Management's assessment of the likelihood of any claim being successful, and the resultant financial implication
- ▶ Review of the adequacy of disclosure within the financial statements.

Private Finance Initiative (PFI) Arrangements

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
- ▶ Using our PFI specialists to consider whether the accounting model reflects the operator's model and produces reliable results for the financial statements
- ▶ Ensuring the outputs from the accounting model are correctly reflected in the financial statements, and relevant disclosures have been made

2.2 Responsibilities in respect of fraud and error

We would like to take this opportunity to remind you that management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- ▶ Identifying fraud risks during the planning stages;
- ▶ Enquiry of management about risks of fraud and the controls to address those risks;
- ▶ Understanding the oversight given by those charged with governance of management's processes over fraud;
- ▶ Consideration of the effectiveness of management's controls designed to address the risk of fraud;
- ▶ Determining an appropriate strategy to address any identified risks of fraud, and,
- ▶ Performing mandatory procedures regardless of specifically identified risks.

3. Value for money risks

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.

The National Audit Office has consulted on the audit approach for the Value for Money (VFM) conclusion. As a result, there has been a change effective from 2015/16:

	Previously	Revised from 2015/16
Overall conclusion	In all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2015.	In all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.
Proper arrangements defined by statutory guidance	<ul style="list-style-type: none"> ▶ Securing financial resilience - the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future. ▶ Challenging economy, efficiency and effectiveness - the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity. 	<ul style="list-style-type: none"> ▶ Take informed decisions. ▶ Deploy resources in a sustainable manner. ▶ Work with partners and other third parties.

We expect to be able to adopt an integrated audit approach, so our work on the financial statement audit feeds into our consideration of the arrangements in place for securing economy, efficiency and effectiveness.

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

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice which defines as:

“A matter is significant if, in the auditor’s professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public”

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the following significant VFM risks which we view as relevant to our value for money conclusion.

Significant value for money risks**Our audit approach****Proper arrangements for sustainable resource deployment**

Proper arrangements for sustainable resource deployment involve planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.

At the start of the 2015/16 financial year the Council did not have a sustainable Medium Term Financial Plan (MTFP).

A MTFP was drawn up early on in 2015/16 and that revealed a shortfall of revenue to the order of £16m by 2018/19. This shortfall was made public, and the Council engaged in a dialogue with Central Government on how to address the issues faced.

Following the Autumn 2015 spending review, the Council revisited the MTFP and were able to construct a balanced 3 year budget. This budget was approved by full Council in February 2016.

The absence of a sustainable MTFP for the majority of the 2015/16 financial year under audit presents a significant risk to our value for money conclusion.

Our approach will focus on:

- ▶ The adequacy of the Council's medium term financial planning process;
- ▶ The robustness of any assumptions;
- ▶ The effective use of scenario planning in medium term financial planning;
- ▶ The effectiveness of in year monitoring against the budget;
- ▶ The Council's approach to prioritising resources, identifying and delivering savings programmes in the short, medium and long term.

Proper arrangements for informed decision making

The Council is expected to act in the public interest, through demonstrating and applying the principles and values of sound governance.

The Council has exhibited weaknesses in its Governance arrangements. These were primarily disclosed in the 13/14 annual governance statement, and again in the 14/15 annual governance statement.

Investigations into historical claims of governance failings continue and the journey to good governance at Derby is ongoing.

We therefore consider that this presents a significant risk to our value for money conclusion.

Our approach will focus on:

- ▶ Review of the Council's risk register
- ▶ Meetings with Chief Officers
- ▶ Review of the minutes of key committee meetings
- ▶ Maintaining an on-going dialogue with Grant Thornton as they conclude their investigations into whistleblowing allegations

We are in dialogue with Grant Thornton who, as the committee are aware, is currently undertaking an investigation of governance issues. We are alert to the impact that these investigations may have on our VFM risk assessment.

We will keep our risk assessment under review throughout our audit and communicate to the Audit Committee any revisions to the specific risks identified and any additional local risk-based work we may need to undertake as a result.

4. Our audit process and strategy

4.1 Objective and scope of our audit

Under the Code of Audit Practice our principal objectives are to review and report on the Council's:

- ▶ Financial statements
- ▶ 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 and Ireland).

We will also review and report to the NAO on the Whole of Government Accounts return to the extent and in the form they require.

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.

4.2 Audit process overview

Reliance on Internal Controls

Our intention was to test the internal controls in place at the Council and place reliance upon them. However, our initial procedures to document and understand the processes and controls in place at the Council have highlighted some control weaknesses which we feel it appropriate to communicate to the Audit Committee at this early stage.

Observation	Impact	Management Response
<p>Derby City Council's debt policy states: <i>'Future trading with bad debtors should be avoided and both the central Debtors team and the Departments providing the good/service have a role to play in achieving this.'</i></p> <p>This policy has not being followed. We have observed in the aged debtors listing how customers have been allowed to carry on making</p>	<p>Increased risk to the Council of irrecoverable debt.</p> <p>Weakened cash-flow.</p>	<p>Reports contained within Oracle do not currently provide adequate information to allow Department to easily identify bad debtors. A specification for improved reporting requirements has been produced. The Council is in the process of obtaining quotes from our data warehouse administrators. Once available these reports will allow service providers to make better informed</p>

Observation	Impact	Management Response
purchases from departments, despite still owing debt.		decisions.
Control account reconciliations are not being reviewed	Increased risk of errors in the financial statements	These reconciliations are always reviewed at year end preventing errors in the financial statements as they are integral to the debtors/creditors disclosures and bad debt provision calculation. Interim checks of the reconciliations are normally conducted, however the implementation of the new income system has had a higher priority in the current year. The reconciliations are still regularly completed by a principal officer and we have not experienced any problems previously.
Council tax discounts and exemptions are not reviewed for appropriateness and are not subject to independent approval	Increased risk of inappropriate discounts and exemptions being applied, impacting revenue generated by the Council.	Information is issued with our Council Tax bills setting out the customers' duty to notify us should the circumstances giving rise to a discount or exemption change. We have also done a thorough single person discount review in the past (part of a Derbyshire wide project undertaken by Capita). Undertaking reviews is included within the revised collection strategy. The 2016/17 MTFP recognised the need to increase recovery and included £100,000 additional resource for Council Tax staffing. This addition capacity will allow more recovery work including discount reviews to be completed.
The Oracle system allows the same individual to prepare and post a journal to the accounts.	Heightened risk of inappropriate/incorrect journals being posted to the accounts.	The Oracle system was implemented in 2007 and this process has operated since then. The Council implemented the retrospective checking of these journals in recognition of the lack of system control. During this time no journals of this type have required reversing/correction. The Council is due to replace its

Observation	Impact	Management Response
		financial management system in 2017. Due to the historic low risk and short time frame remaining the Council is not proposing a change to the current arrangements.
When performing our interim procedures in respect of the Housing Benefits system, we noted that although the monthly reconciliation of Academy payments to the general ledger were conducted, those for October, November and December 2015 were not reviewed by the Principal Accountant.	Increased risk of errors in the financial statements	The monthly reconciliation of Academy Payments module for October, November and December has now been completed.
The supporting workpapers underpinning the Council's Medium Term Financial Strategy which detail the assumptions used in the plan, and the build-up of income and expenditure over the three year period is stored on the Council's server as a Microsoft Excel file which is open for all Council employees to access and edit.	Increased risk of accidental or intentional error within the models which could have a significant impact on the Council's ability to make informed decisions.	The MTFP spread sheet includes a reconciliation element that would help to identify accidental error. However the Council will also password protect the working document for the 2016/17 MTFP process. This password will only be shared between the officers responsible for controlling and inputting into the MTFP workings.

Consolidation of Derby Homes Limited

As noted in section 1, our audit of the consolidated financial statements of Derby City Council will include procedures to direct, oversee and conclude upon the work performed by BDO LLP as auditor of Derby Homes Limited in support of the group audit opinion. Further details can be found in Appendix C.

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
- ▶ 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 & Accounts Committee.

Internal audit

We will 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 we raise issues that could have an impact on the year-end financial statements

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
Property, Plant & Equipment	Council's valuation team EY valuations team
Defined Benefit Pension Scheme assets and liabilities	Pension scheme actuary EY Pensions team
Private Finance Initiative (PFI) schemes	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 environment 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 expert 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.

4.3 Mandatory audit procedures required by auditing standards and the Code

As well as the financial statement risks (section two) and value for money risks (section three), we must 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;
- ▶ 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.
- ▶ Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

Finally, we are also required to discharge our statutory duties and responsibilities as established by the Local Audit and Accountability Act 2014.

4.4 Materiality

For the purposes of determining whether the financial statements are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in aggregate, could reasonably be expected to influence the users of the financial statements. Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition.

We have determined that overall materiality for the consolidated financial statements of the Council is £6.9 million based on 1% of Gross Expenditure. We will communicate uncorrected audit misstatements greater than £346k to you.

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 the circumstances that might ultimately influence our judgement. 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 financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

4.5 How materiality is applied to the component locations

We are responsible for assessing that the aggregate of detected and undetected misstatements in the financial information of the component (Derby Homes Limited), accumulated at group level, is not material to the group financial statements (i.e., does not exceed group materiality).

To achieve this, we assign a materiality level to component teams to use when designing their audit procedures. We determine component materiality as a percentage of Group materiality based on risk and relative size to the Group. Based on the planning materiality of £6.9 million, we have assigned 30% to Derby Homes Limited. The component reporting limit for adjustments of £346k is the same as that noted above.

Since Derby City Council represents such a large proportion of the group, we will audit the Council at the Group materiality level noted above.

4.6 Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant 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 NAO Code. The indicative fee scale for the audit of Derby City Council is £142,533.

4.7 Your audit team

The engagement team is led by Steve Clark, who has significant experience of local authority audits. Steve is supported by Helen Henshaw, 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 Finance.

4.8 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit, including the value for money work and the Whole of Government Accounts. The timetable includes the deliverables we have agreed to provide to the Council through the Audit & Accounts Committee's cycle in 2015/16. These dates are determined to ensure our alignment with PSAA's rolling calendar of deadlines.

From time to time matters may arise that require immediate communication with the Audit & Accounts Committee and we will discuss them with the Chair as appropriate.

Following the conclusion of our audit we will prepare an Annual Audit Letter to communicate the key issues arising from our work to the Council and external stakeholders, including members of the public.

Audit phase	Timetable	Audit & Accounts Committee timetable	Deliverables
High level planning	Oct-Dec 2015		
Risk assessment and setting of scopes	Jan 2016	March 2016	Audit Plan
Testing routine processes and controls	Jan 2016	March 2016	Audit Plan
Year-end audit	July 2016	Sept 2016	
Completion of audit	July 2016	Sept 2016	Report to those charged with governance via the Audit Results Report Audit report (including our opinion on the financial statements and overall value for money conclusion). Audit completion certificate (dependent on status of prior year audit completion certificates) Reporting to the NAO on the Whole of Government Accounts return.
Conclusion of reporting	October 2016	December 2016	Annual Audit Letter
Housing Benefit Subsidy Claim	May – November 2016		Certified Claim
Reporting on certification work	December 2016	January 2017	Annual certification work report

In addition to the above formal reporting and deliverables we will seek to provide practical business insights and updates on regulatory matters.

5. Independence

5.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 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 on our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we do this formally both at the planning stage and at the conclusion of the audit, as well as during 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

- ▶ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between 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.

Final stage

- ▶ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, 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 we are independent;
- ▶ Details of any inconsistencies between APB Ethical Standards, the PSAA Terms of Appointment and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and
- ▶ An opportunity to discuss auditor independence issues.

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, 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 contracted services, and details of any written proposal to provide non-audit services;

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

5.2 Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including any principal threats. However we have adopted the safeguards below to mitigate these threats along with the reasons why they are considered to be effective.

Self-interest threats

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; 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 the Council.

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 the Council has approved and that are in compliance with PSAA Terms of Appointment.

At the time of writing, there are no non-audit fees.

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 the Council. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in compliance with Ethical Standard 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 other 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 your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions 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.

Overall Assessment

Overall we consider that the adopted safeguards appropriately mitigate the principal threats identified, and we therefore confirm that EY is independent and the objectivity and independence of Steve Clark, the audit engagement Partner and the audit engagement team have not been compromised.

5.3 Other required communications

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 within EY for maintaining objectivity and independence can be found in our annual Transparency Report, which the firm is required to publish by law. The most recent version of this report is for the year ended June 2015 and can be found here:

<http://www.ey.com/UK/en/About-us/EY-UK-Transparency-Report-2015>

Appendix A Fees

A breakdown of our agreed fee is shown below.

	Planned Fee 2015/16 £	Scale fee 2015/16 £	Outturn fee 2014/15 £	Explanation
Opinion Audit and VFM Conclusion	142,553	142,553	190,070	
Total Audit Fee – Code work	142,553	142,553	190,070	
Certification of claims and returns ¹	20,846	20,846	26,770	
Non-audit work	-	-	44,948	

All fees exclude VAT.

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

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ The operating effectiveness of the internal controls for the following key processes:
 - ▶ Property, Plant & Equipment
 - ▶ Accounts receivable
 - ▶ Accounts payable
 - ▶ Income processes
 - ▶ Payroll
- ▶ Our accounts opinion and value for money conclusion being unqualified;
- ▶ Appropriate quality of documentation is provided by the Council; and
- ▶ The Council has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.

At the time of writing we anticipate seeking a scale-fee variation in respect of:

- ▶ Ineffective internal controls noted in section 4.2 above
- ▶ Additional audit procedures required in respect of the valuation of property, plant and equipment
- ▶ Change in scope of the audit with respect to Derby Homes Limited

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

¹ Our fee for the certification of grant claims is based on the indicative scale fee set by the PSAA.

Appendix B UK required communications with those charged with governance

There are certain communications that we must provide to the Audit & Accounts Committee. These are detailed here:

Required communication	Reference
<p>Planning and audit approach Communication of the planned scope and timing of the audit including any limitations.</p>	▶ Audit Plan
<p>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ 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 	▶ Report to those charged with governance
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ In writing, corrected misstatements that are significant 	▶ Report to those charged with governance
<p>Fraud</p> <ul style="list-style-type: none"> ▶ Enquiries of the Audit & 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 	▶ Report to those charged with governance
<p>Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ 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 	▶ Report to those charged with governance
<p>External confirmations</p> <ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures 	▶ Report to those charged with governance
<p>Consideration of laws and regulations</p> <ul style="list-style-type: none"> ▶ 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 & Accounts 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 & Accounts Committee may be aware of 	▶ Report to those charged with governance

Required communication	Reference
<p>Independence</p> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement director's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ 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 	<ul style="list-style-type: none"> ▶ Audit Plan ▶ Report to those charged with governance
<p>Going concern</p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ 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 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Significant deficiencies in internal controls identified during the audit</p>	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Fee Information</p> <ul style="list-style-type: none"> ▶ Breakdown of fee information at the agreement of the initial audit plan ▶ Breakdown of fee information at the completion of the audit 	<ul style="list-style-type: none"> ▶ Audit Plan ▶ Report to those charged with governance ▶ Annual Audit Letter if considered necessary
<p>Group audits</p> <ul style="list-style-type: none"> ▶ 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 	<ul style="list-style-type: none"> ▶ Audit Plan ▶ Report to those charged with governance
<p>Opening Balances (initial audits)</p> <ul style="list-style-type: none"> ▶ Findings and issues regarding the opening balance of initial audits 	<ul style="list-style-type: none"> ▶ Report to those charged with governance
<p>Certification work</p> <ul style="list-style-type: none"> ▶ Summary of certification work undertaken 	<ul style="list-style-type: none"> ▶ Report to those charged with governance

Appendix C Detailed scopes

Our objective is to form an opinion on the group's consolidated financial statements under International Standards on Auditing (UK and Ireland).

We set audit scopes for each reporting unit which together enable us to form an opinion on the group accounts. We take into account the size, risk profile, changes in the business environment and other factors when assessing the level of work to be performed at each reporting unit.

The preliminary audit scope assigned to Derby City Council is full scope.

The preliminary audit scope assigned to Derby Homes Limited is full scope.

Full scope locations are deemed significant based on size and those with significant risk factors are subject to a full scope audit, covering all significant accounts and processes using materiality levels assigned by the Group audit team for the purposes of the consolidated audit. Procedures are full-scope in nature, but may not be sufficient to issue a stand-alone audit opinion on the local statutory financial statements (as materiality thresholds support the consolidated audit).

ISA 600 (UK and Ireland) requires that we provide you with an overview of the nature of our planned involvement in the work to be performed by the component auditors of significant locations/reporting units. Our involvement can be summarised as follows:

- ▶ Audit of Derby City Council to occur concurrently with the audit of the group, and be performed by the same EY audit team.
- ▶ Issue of instructions to the external auditor of Derby Homes Limited (BDO), the component auditor, to direct their work for the purposes of the consolidated financial statements of Derby City Council.
- ▶ Obtain an understanding of the competence and capabilities of the component auditor.
- ▶ Review the output of the component auditor's work as reported to us and conclude on its sufficiency for the purposes of our audit opinion on the consolidated financial statements.

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