Derby City Council
Audit planning report

Year ended 31 March 2019

27th March 2019

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12th March 2019

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 2018/19 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 27th March 2019 as well as understand whether there are other matters which you consider may influence our audit.

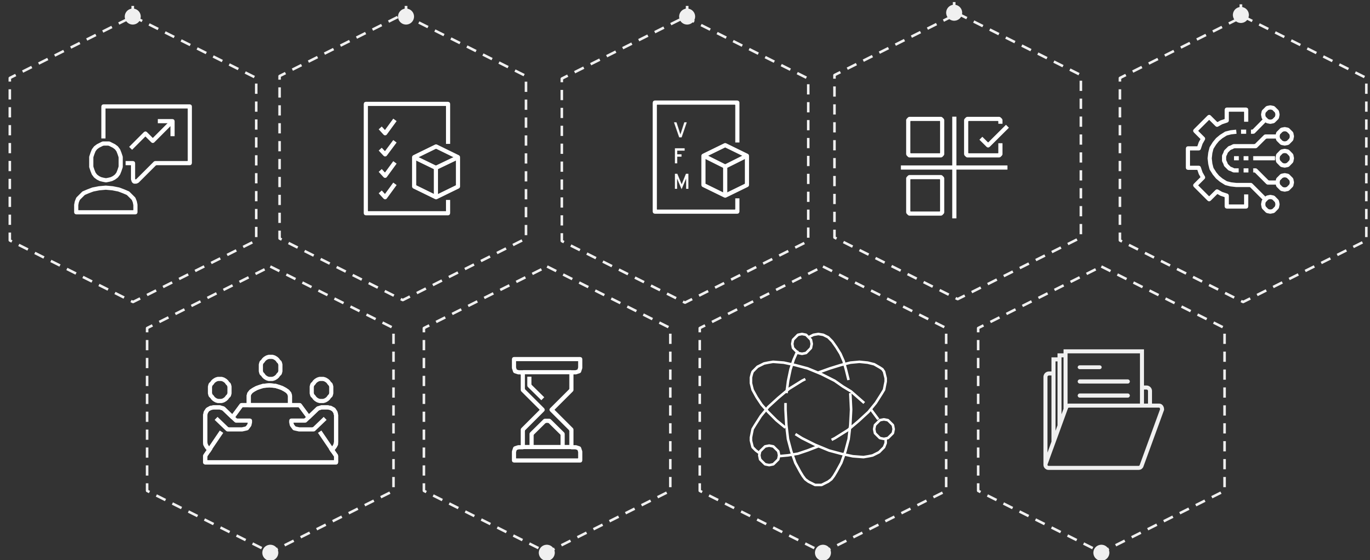
Yours faithfully

S R Clark

Stephen Clark

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 2018/19 audit strategy

Overview of our 2018/19 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 and capitalisation of revenue expenditure.	Fraud risk	No change in risk or 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. The risk manifests itself in the arrangements to ensure that year-end accruals are reasonable and correctly accounted for and therefore we will complete work to get assurance on year end accruals, focusing on fees, charges and other service income, and other service expenditure. We also believe the risk is linked to the existence of capital expenditure arising from the potential to incorrectly capitalise revenue expenditure. 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	Significant Risk	No change in risk or focus	Property, Plant and Equipment accounts for a significant proportion of the Council's total assets and the rolling valuation process incorporates significant judgements, which if inappropriate could result in a material misstatement. There were material adjustments in the 2015/16 and 2016/17 financial statements and a change in valuer from 2017/18, this account continues to be a significant audit risk.
PFI Financing	Other financial statement 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.

Overview of our 2018/19 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
Valuation of LGPS Liability	Other financial statement 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 was £376.9 million as at 31 March 2018. 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. The 2017/18 audit identified that the Council's share of the asset was understated by £2.3m, given the date of the EU exit, the turmoil could result in material under / over statement of the assets. Both these be an area of audit focus. Further details are provided at page 13.
Follow up of statutory written recommendations issued June 2017	Other financial statement risk	No change in risk or focus	EY issued written recommendations to the Council under s24 of the Local Audit and Accountability Act in June 2017. It is now over 18 months since we presented our statutory recommendations to the Council, the report presented to the audit committee in February 2019 by internal audit shows majority of the recommendation have been addressed, we will follow up progress during our interim and final audit visits to review the recommendations have been satisfactory concluded.
IFRS 9 – Financial statements	Other financial statement risk	New risk	These are new accounting standards applicable for local authority accounts from for the 2018/19 financial year. There is a risk that the Council does not implement the requirements of the standards correctly. Further details of the risk are provided at page 14.
IFRS 15 – Revenue contracts with customers	Other financial statement risk	New risk	

Overview of our 2018/19 audit strategy

Materiality

Planning materiality

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

Performance materiality

Performance materiality has been set at 50% 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 Accounts and Audit Committee.

Entity	Basis of materiality	Planning materiality	Performance materiality	Audit differences
Group	Gross revenue expenditure	£6.54m	£3.27m	£0.33m
The Council	Gross revenue expenditure	£6.57m	£2.78m	£0.33m

Overview of our 2018/19 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 2019 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.

Audit team changes

Key changes to our team.

Senior Manager
Vishal Savjani

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 and capitalisation of revenue expenditure.

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. These accounts had the following balances in the 2017/18 financial statements:

Income Account: £731m

Expenditure Account: £749m

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 expenditure recognition, we believe the risk is focused on year-end balance sheet and in particular the completeness and valuation of creditors and the existence and valuation of debtors. There is also a risk of incorrect cut-off in relation to revenue and or expenditure leading to transactions being reported in the wrong period.

We also believe the risk is linked to the existence of capital expenditure arising from the potential to incorrectly capitalise revenue expenditure.

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.
- Test the valuation of any provisions recorded in the financial statements and perform appropriate tests to consider whether all material provisions have been recognised.
- Develop a testing strategy to test material debtors and creditors.
- Test the cut-off of income and expenditure to ensure transactions are recorded within the correct period to which they relate
- Sample test additions to property, plant and equipment to test whether the Council has inappropriately capitalised revenue expenditure.

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.

Audit risks

Our response to significant risks (continued)

Valuation of land and buildings

What is the risk?	Our audit approach
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 fair value of other land and buildings represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. 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 specifically to assess if the movement on the unvalued population has been addressed appropriately ▸ Engage our valuation specialists to support our testing strategy and help evaluate the work of the Council's valuer. ▸ Perform appropriate tests over the completeness and appropriateness of information provided to the valuer ▸ Review the classification of assets and ensure the correct valuation methodology has been applied. ▸ Ensure the valuer's conclusions have been appropriately recorded in the accounts

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?
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
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 2018 this totalled £376.9 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. The 2017/18 audit identified that the Council's share of the asset was understated by £2.3m as a result of the timing of the actuary's work, given the date of the EU exit, the turmoil could result in further material under / over statement of the assets. The Council is planning to obtain a second valuation as at 31 March 2019.	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 ▸ We will review the outcome from the second report from the Actuary in conjunction with a review and testing of the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.
Follow up of statutory written recommendations issued June 2017 EY issued written recommendations to the Council under s24 of the Local Audit and Accountability Act in June 2017. The report presented to the audit committee in February 2019 by internal audit 18 months after we presented our statutory recommendations to the Council shows majority of the recommendation have been addressed.	We will ▸ follow up progress during our interim and final audit visits to review the recommendations have been satisfactory concluded.

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>IFRS 9 financial instruments</u> This new accounting standard is applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial assets. There are transitional arrangements within the standard; and the 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 9. However, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty on the accounting treatment.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; ▸ Consider the classification and valuation of financial instrument assets; ▸ Review new expected credit loss model impairment calculations for assets; and ▸ Check additional disclosure requirements.
<u>IFRS 15 Revenue from contracts with customers</u> This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue will change and new disclosure requirements introduced.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19. This will include Local Authority Trading Companies consolidated into the Authority's Group Accounts; ▸ Consider application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and ▸ Check additional disclosure requirements.

03 Value for Money Risks

Value for Money

Background

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. This is known as our value for money conclusion.

For 2018/19 this is based on the overall evaluation criterion:

"In all significant respects, the audited body 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 are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

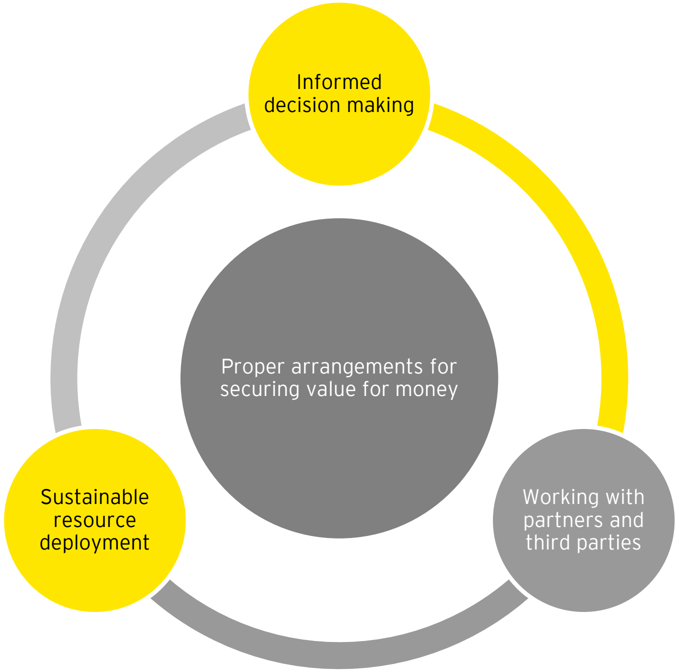
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice 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. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2018/19 this has included consideration of the steps taken by the Council to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Authorities will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

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 identification of the significant risks noted on the following page which we view as relevant to our value for money conclusion.



Value for Money Risks

What arrangements does the risk affect?	What is the significant value for money risk?	What will we do?
Working with partners and other third parties Working with third parties effectively to deliver strategic priorities	Results of regulatory reviews and commentary The Council received various commentary throughout the prior year period from regulatory bodies, the tone of which was mixed. The findings in respect of education provision across the City from Ofsted and more broadly across the Council's activities from the Local Government Association (LGA) Peer Review indicated a significant risk to our VFM conclusion. As a result of the findings and the recommendations made we will monitor the Council's progress in these areas.	Our approach will focus on: ▪ Discussions with Council Officers on actions taken to address the issues raised by Ofsted and the LGA peer review.
Informed Decision Making Managing and utilising assets effectively to support the delivery of strategic priorities	Significant overspend on capital projects The A52 improvement project is a significant capital project, which is still ongoing. The project has been subject to substantial overspend, which highlighted reporting and control issues. At the time of writing, it is reported there is £40m of committed expenditure against a budget of £15m.	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.

Value for Money Risks

What arrangements does the risk affect?	What is the significant value for money risk?	What will we do?
Informed Decision Making Acting in the public interest, through demonstrating and applying the principles and values of sound governance	**June 2016 Public Interest Report** Grant Thornton issued a Report in the Public Interest in June 2016 which highlighted governance issues which remained present in the 2017/18 year of account. This report, and the Council's response to it therefore presents a significant risk to our VFM conclusion. Our work in 2017/18 confirmed the only remaining matter documented in the PIR which has an ongoing implication for DCC is the quality of member/officer relations. This matter was raised again in the Local Government Association report of July 2017.	Our approach will focus on: ▪ Reviewing the Council's progress towards addressing the remaining point raised in the public interest report.
Informed Decision Making Managing risks effectively and maintaining a sound system of internal control' And **Sustainable Resource Deployment** Managing and utilising assets effectively to support the delivery of strategic priorities	**July 2017 written recommendations under s24 of Local Audit and Accountability Act** In June 2017 EY exercised its powers under the Local Audit and Accountability Act 2014 and issued written recommendations to the Council. Although some progress had been made, it was our view that given the significance of the control weaknesses, insufficient progress has been made in the period following our report of 23 September 2016 to appropriately address the issues and strengthen the Council's control environment. The control issues identified across a significant number of areas of the Finance and associated supporting functions, most noticeably in respect of the Estates function, are pervasive and led to a significant number of errors identified in the 15/16 published draft Financial Statements relating to both the current and prior year accounting periods. This could undermine the Council's ability to effectively demonstrate it has proper arrangements to safeguard and make informed decisions in respect of public funds and assets. The work of the internal audit work in respect to the follow-up of s24 recommendations was reported to the audit committee in February 2019, which shows the Council has clearly made progress against addressing many of the control issues communicated in our written recommendations, there are still recommendation to be concluded on 18 months on from when we presented our recommendation the council.	Our approach will focus on: ▸ Reviewing the conclusions of the internal audit in respect to the follow-up of s24 recommendations work carried out and assess findings are consistent with information obtained via our audit work. ▸ Monitor progress against any recommendation arising from the work of internal audit.

Value for Money Risks

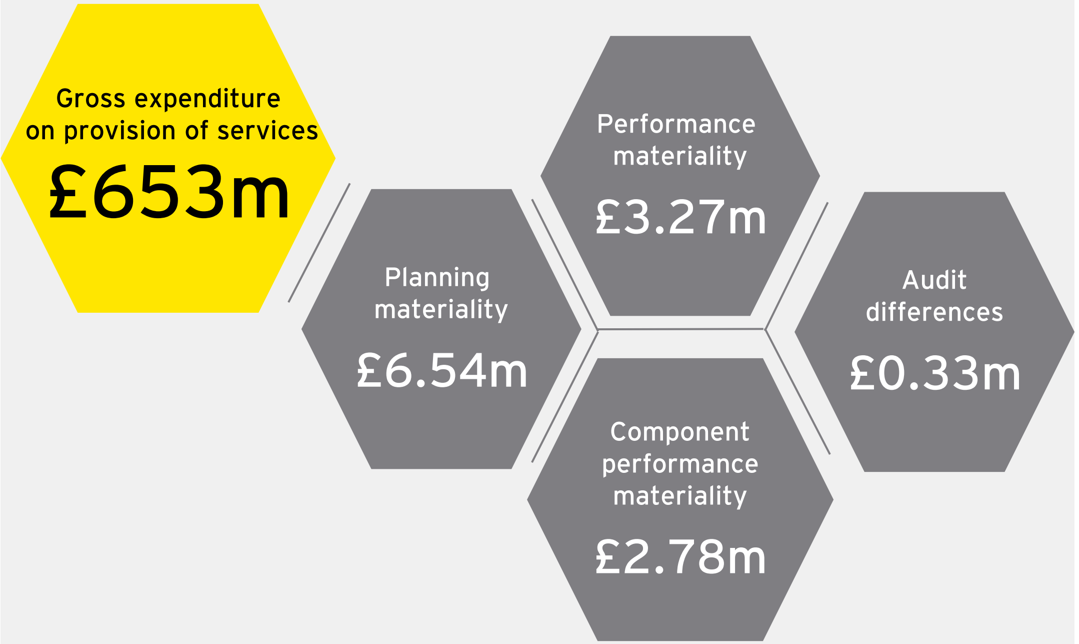
What arrangements does the risk affect?	What is the significant value for money risk?	What will we do?
Sustainable Resource Deployment Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions	Robustness of medium term financial planning The Council's Medium Term Financial Plan and planning process have not previously been sufficiently robust. Savings targets were not accompanied by detailed plans on how the savings are to be achieved. There is no provision for scenario planning to identify financial sensitivities within the Medium Term Financial Plan. We have been informed of changes implemented in this area, but there is a risk present as we must ascertain whether the changes have been embedded within the Council. This therefore presents a significant risk to our Value For Money conclusion	Our approach will focus on: ▪ Reviewing the arrangements that the Council has put in place for identifying medium term savings requirement; ▪ Understanding the operation of Medium Term Financial Plan and Planning activities with the s151 Officer to confirm nature and extent of any improvements made from prior years. ▪ Review the amendments made to the savings identification and planning processes.
Working with partners and other third parties Working with third parties effectively to deliver strategic priorities	Provision of internal audit services In the prior year, our view was that the reporting to the Committee by internal audit is superficial, and the challenge provided by the audit committee to the matters raised by internal audit was often weak. In early 2017 the Council initiated a review of the internal audit service offering, a transformation programme was initiated and improvements were made. We will continue to monitor progress in 2018-19.	Our approach will focus on: ▪ Monitoring the implementation of the transformation programme.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2018/19 has been set at £6.54m for the Group and £6.57m for the Council. This represents 1% of the prior 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 D.



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 £6.54m which represents 50% 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) £2.78m
- Derby Homes Limited £0.65m

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.

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 2018/19 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 and Accounts 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.

Scope of our audit

Our Audit Process and Strategy (continued)

Earlier deadline for production of the financial statements

The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July.

These changes provide risks for both the preparers and the auditors of the financial statements:

- The Council now has less time to prepare the financial statements and supporting working papers. Risks to the Council include delivering data for analytics work in format and to time required, late working papers and internal quality assurance arrangements
- As your auditor, we have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within same compressed timetable. Slippage at one client could potentially put delivery of others at risk.

To mitigate this risk we will require:

- good quality draft financial statements and supporting working papers by the agreed deadline;
- appropriate Council staff to be available throughout the agreed audit period; and
- complete and prompt responses to audit questions.

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.

To support the Council we will:

- Work with the Council to engage early to facilitate early substantive testing where appropriate.
- Provide an early review on the Council's streamlining of the Statement of Accounts where non-material disclosure notes are removed.
- Facilitate faster close workshops to provide an interactive forum for Local Authority accountants and auditors to share good practice and ideas to enable us all to achieve a successful faster closure of accounts for the 2018/19 financial year.
- Work with the Council to embed the use of EY Client Portal, this will:
  - Streamline our audit requests through a reduction of emails and improved means of communication;
  - Provide on-demand visibility into the status of audit requests and the overall audit status;
  - Reduce risk of duplicate requests; and
  - Provide better security of sensitive data.
- Agree the team and timing of each element of our work with you.
- Agree the supporting working papers that we require to complete our audit.

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. We provide scope details for each component within Appendix E.

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

06 Audit team

Audit team

Audit team structure:

Stephen Clark
Lead Audit Partner

Vishal Savjani
Senior Manager

Gary Morris
Assistant Manager

Ann-Marie Butler
Senior

EY Actuaries

EY Valuations Team

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

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 2018/19.

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.

Reporting our independence, risk assessment, planned audit approach and the scope of our audit

Audit Plan

Reporting our conclusions on key judgements and estimates and confirmation of our independence

Audit Results Report

The Annual Audit Letter will be provided following completion of our audit procedures

Annual Audit Letter

Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
		Planning		Walkthroughs		Interim Audit			Substantive testing		

Planning

Risk assessment and setting of scopes

Walkthroughs

Walkthrough of key systems and processes

Interim Audit

Early substantive testing

Year End Audit

Work begins on our year end audit. This is when we will complete any substantive testing not completed at interim

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

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non –audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Stephen Clark, 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 18%. 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.

Relationships, services and related threats and safeguards

Other threats

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

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

EY Transparency Report 2017

Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2018 and can be found here:

https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

09 Appendices

Appendix A

Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2018/19 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 2018/19	Scale fee 2018/19	Final Fee 2017/18
	£	£	£
Total Fee – Code work	109,766	109,766	142,553
Additional fees	TBD	0	40,000
Total audit	TBD	109,766	182,553
Housing Benefit Subsidy Claim	TBD	0	20,846
Teacher's Pension Audit	TBD	0	6,000
Pooling of Housing Capital Receipts	TBD	0	4,500
Total other non-audit services	TBD	0	31,346
Total fees	TBD	109,766	213,899

All fees exclude VAT

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 Council; and
- The Council has an effective control environment.

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

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

Appendix B

Required communications with the Audit Committee

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

		Our Reporting to you
Required communications	**What is reported?**	**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 - March 2019
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 - July 2019

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 – July 2018
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 – July 2018
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 – July 2018
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 – July 2018

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**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 – March 2019 Audit Results Report – July 2019

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**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 - July 2019
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 and 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 and Accounts Committee may be aware of	Audit Results Report - July 2019
Internal controls	▶ Significant deficiencies in internal controls identified during the audit	Audit Results Report - July 2019
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 - March 2019 Audit Results Report - July 2019

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report – July 2019
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report – July 2019
Auditors report	▶ Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report – July 2019
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 – March 2019 Audit Results Report – July 2019
Certification work	Summary of certification work undertaken	Certification report – February 2020

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 and Accounts Committee** reporting appropriately addresses matters communicated by us to the **Audit and Accounts Committee** and reporting whether it is materially inconsistent with our understanding and the financial statements; and ‣ Maintaining auditor independence.

Appendix C

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.