Derby City Council
Audit planning report

Year ended 31 March 2020

4 June 2020

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4th June 2020

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 2019/20 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. Our planned audit strategy and risk assessment was substantially completed prior to the unprecedented events with the COVID-19 outbreak and social distancing measures introduced in the United Kingdom from the end of March 2020 We have adapted our audit approach and working practices to take account of the implications and risks from COVID-19 as we see them for the preparers of financial statements and auditors for Local Government bodies. We have had initial discussions with the Council's finance team on their response and ongoing strategic, operational and financial risk assessment. We will continue to keep this area under review during the course of our audit and update our audit risk assessment and approach as appropriate. At this stage, we expect to be undertaking additional audit procedures on the valuation of the Council's assets, recognition of grant income and our assessment of management's assertions and disclosures associated with preparing the accounts as a going concern in accordance with the Financial Reporting Council's Statement of Recommended Practice Note 10 for audit of public sector bodies in the United Kingdom.

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, as well as understand whether there are other matters which you consider may influence our audit.

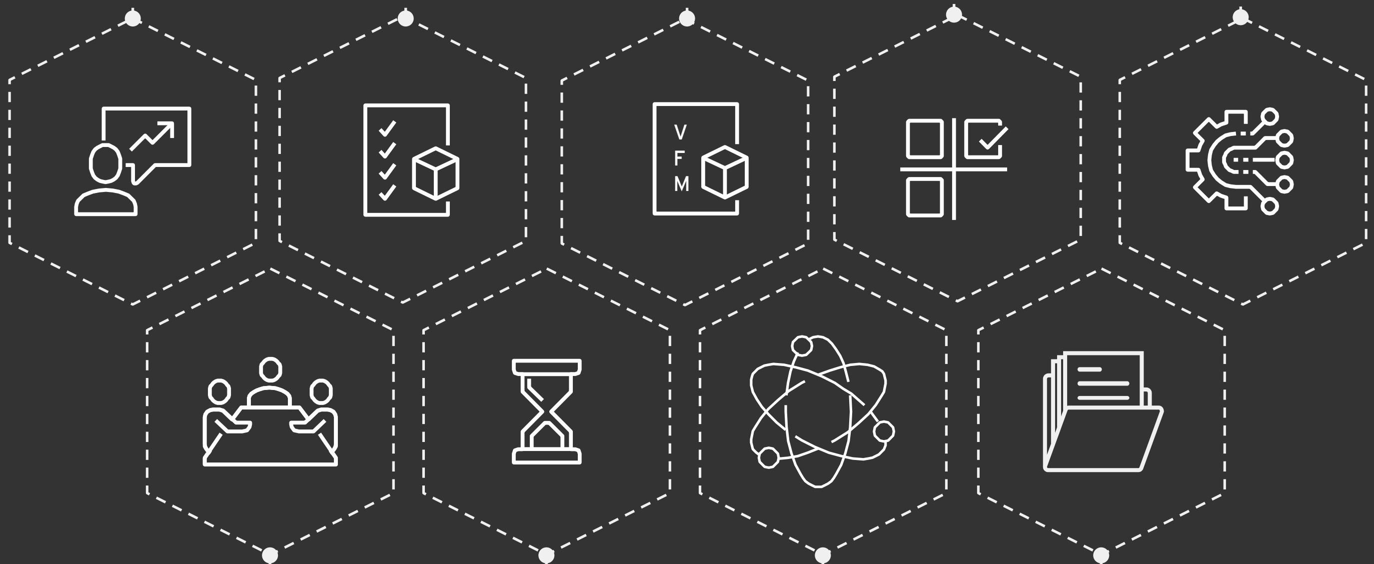
Yours faithfully

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 2019/20 audit strategy

Overview of our 2019/20 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 11.
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 12.
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 is increased uncertainty on valuations post covid 19, particularly relevant for Fair Value / Market Value based assets because of the paucity of market information available at 31 March upon which to give those valuations. Any material uncertainty will impact on our audit opinion. Further details are provided at page 13.
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. Further details are provided at page 14.

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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 £466.5 million as at 31 March 2019. The estimation of the defined benefit obligations is sensitive to a range of assumptions such as rates of pay and pension inflation, mortality and discount rates. The pension fund valuations separately involve external specialists, to provide these actuarial assumptions. A small movement in these assumptions could have a material impact on the value in the balance sheet. Further details are provided at page 14.
Accounting for SinFin Waste Plant	Other financial statement risk	New risk	Derby City Council and Derbyshire County Council contracted with Resource Recovery Solutions Derbyshire (RRS) to manage the Sinfin Waste Plant. The waste treatment centre was due to open in Sinfin in 2017, but RRS has been unable to resolve ongoing issues that would allow the facility to pass the certified performance tests required to bring it into full service. In April, the two councils issued a formal notice to the project's funders to take action under the contract to progress the project. The agreement with RRS to manage the Sinfin Waste Plant was cancelled in August 2019 when the banks funding the project issued a legal notice. There is a risk that any associated transactions are not accurately accounted for in the financial statements. Further details of the risk are provided at page 15.
Recognition of grant income	Other financial statement risk	New risk	The Council has received additional funding in the form of grants as a result of the Covid-19. There is the potential for the recognition and treatment of these grants to be manipulated to improve the reported position. We will consider the elements of grant income, their susceptibility to manipulation and the appropriate audit response. Further details of the risk are provided at page 15

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Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Going Concern - ISA 570 (updated accounting standard)	Other financial statement risk	New risk	These are new and updated accounting standards applicable for local authority accounts . There is a risk that the Council does not implement the requirements of the standards correctly. We will discuss the detailed implications of the new standard with finance staff during 2019/20 ahead of its application for 2020/21. In particular, we will undertake sufficient and appropriate audit procedures to review the adequacy of management's disclosures, assumptions and stress testing on their assessment of going concern in response to Covid-19. Further details of the risk are provided at page 16 and areas of the accounts impacted on page 17.

Overview of our 2019/20 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) consistent with prior years.

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	£6.50m	£3.25m	£0.33m
The Council	Gross revenue expenditure	£6.55m	£2.76m	£0.33m

Further details of how performance materiality has been calculated is at page 23.

Overview of our 2019/20 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 2020 and of the income and expenditure for the year then ended; and

- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements;
- Developments in financial reporting and auditing standards;
- The quality of systems and processes;
- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

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

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 15 in recent years as well as the expansion of factors impacting the value for money conclusion. The extent of these or any other risks relevant in the context of Derby City Council's audit, have been discussed with management as to the impact on the scale fee, for further details please see Appendix A.

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 2018/19 financial statements:

Income Account: £695m

Expenditure Account: £764m

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.

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 There is increased uncertainty on valuations post covid 19, particularly relevant for Fair Value / Market Value based assets because of the paucity of market information available at 31 March upon which to give those valuations. We will consider how the Council's valuer has addressed the impact of Covid-19 in the year-end valuation of assets and assessment of impairments. Any material uncertainty will impact on our audit opinion.

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 ▸ Consider the impact of Covid-19 on the financial stability of providers.
Pension Liability Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Derbyshire County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2019 this totalled £466.5 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: ▸ Liaise with the auditors of Derbyshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Derby City Council; ▸ Assess the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. We will consider outturn information available at the time we undertake our work after production of the Council's draft financial statements, for example the yearend actual valuation of pension fund assets. We will use this to inform our assessment of the accuracy of estimated information included in the financial statements and whether any adjustments are required.

Other areas of audit focus

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?
Accounting for SinFIn Waste Plant Derby City Council and Derbyshire County Council contracted with Resource Recovery Solutions Derbyshire (RRS) to manage the Sinfin Waste Plant. The waste treatment centre was due to open in Sinfin in 2017, but RRS has been unable to resolve ongoing issues that would allow the facility to pass the certified performance tests required to bring it into full service. In April, the two councils issued a formal notice to the project's funders to take action under the contract to progress the project. The agreement with RRS to manage the Sinfin Waste Plant was cancelled in August 2019 when the banks funding the project issued a legal notice. There is a risk that any associated transactions are not accurately accounted for in the financial statements.	Our approach will focus on: ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to Waste Plant.
Recognition of grant income The Council has received additional funding in the form of grants as a result of the Covid-19. There is the potential for the recognition and treatment of these grants to be manipulated to improve the reported position	We will: ▸ Consider the revenue and capital grants received by the Council; ▸ Assess the potential for manipulation of individual grant streams; and ▸ Responsive to the risk, carry out testing to ensure the accounting treatment and recognition applied to grant income is appropriate.

Audit risks (Delete – Old going concern slide)

Other areas of audit focus

What is the risk/area of focus?	What will we do?
Going Concern Covid-19 has created a number of financial pressures throughout Local Government. Dependent on the circumstances of the individual body it is creating financial stress in either or a combination of increasing service demand leading to increased expenditure in specific services, and reductions in income sources. There is currently not a clear statement of financial support from MHCLG that covers all financial consequences of Covid-19. There have been a number of media stories in both the national press and trade publications raising the possibilities of an increase in Chief Financial Officers using their s114 powers. This could be under s114(3), insufficient resources to fund likely expenditure. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 *Going Concern*, as applied by Practice Note 10: *Audit of financial statements of public sector bodies in the United Kingdom*, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements. The auditor's report in respect of going concern covers a 12-month period from the date of the report, therefore the Council's assessment will also need to cover this period.	In light of the unprecedented nature of Covid-19, its impact on the funding of public sector entities and uncertainty over the form and extent of government support, we will be seeking a documented and detailed consideration to support management's assertion regarding the going concern basis and particularly with a view whether there are any material uncertainties for disclosure. We will review your updated going concern disclosures within the financial statements under IAS1, and associated financial viability disclosures within the Narrative Statement. We expect you to disclose any material uncertainties that do exist. These disclosures should also include the process that has been undertaken for revising financial plans and cashflow, liquidity forecasts, known outcomes, sensitivities, mitigating actions including but not restricted to the use of reserves, and key assumptions (e.g. assumed duration of Covid-19). Our audit procedures to review these will include consideration of: ▸ Current and developing environment; ▸ Liquidity (operational and funding); ▸ Mitigating factors; ▸ Management information and forecasting; and ▸ Sensitivities and stress testing.

Other areas of audit focus (continued)

Impact of Covid-19

The ongoing disruption to daily life and the economy as a result of the Covid-19 virus will have a pervasive impact upon the financial statements. Understandably, the priority for the Council to date has been to ensure the safety of staff and the delivery of business critical activities. However, the financial statements will need to reflect the impact of Covid-19 on the Council's financial position and performance. Due to the significant uncertainty about the duration and extent of disruption, at this stage we have not identified specific risks related to Covid-19, but wish to highlight the wide range of ways in which it could impact the financial statements. In addition to our comments on going concern at page 17, these may also include, but not be limited to:

- **Revenue recognition –** there may be an impact on income collection (council tax and business rates) if businesses and residents are unable to work and earn income due to the lockdown and restriction of movement due to COVID-19.
- **Tangible assets –** there may be impairment of tangible assets if future service potential is reduced by the economic impact of the virus. The Council may also have already incurred capital costs on projects where the economic case has fundamentally changed.
- **Pensions** – volatility in the financial markets is likely to have a significant impact on pension assets, and therefore net liabilities.
- **Receivables** – there may be an increase in amounts written off as irrecoverable and impairment of year-end balances due to the increased number of businesses and residents unable to meet their financial obligations.
  Events after balance sheet date – there is an increased risk that further events after the balance sheet date concerning the current Covid-19 pandemic will need to be disclosed. The amount of detail required in the disclosure needs to reflect the specific circumstances of the Authority
- **Government support –** any Covid-19 specific government support is likely to be a new transaction stream and may require development of new accounting policies and treatments
- **Holiday and sickness pay** – the change in working patterns may result in year-end staff pay accruals which are noticeably different to prior years.
- **Annual Governance Statement–** the widespread use of home working is likely to change the way internal controls operate. The Annual Governance Statement will need to capture how the control environment has changed during the period up to the date of approval of the accounts and what steps were taken to maintain a robust control environment during the disruption. This will also need to be considered in the context of internal audit's ability to issue their Head of Internal Audit opinion for the year, depending on the ability to complete the remainder of the internal audit programme where this is not yet complete.

We will provide an update on the impact of Covid-19 on the Council's financial statements, and how we have responded to the additional risks of misstatement, later in our audit.

In addition to the impact on the financial statements themselves, the disruption caused by Covid-19 may impact on management's ability to produce the financial statements and our ability to complete the audit to the planned timetable. For example, it may be more difficult than usual to access the supporting documentation necessary to support our audit procedures. There will be additional audit procedures we have to perform to respond to the additional risks caused by the factors noted above.

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 2019/20 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.

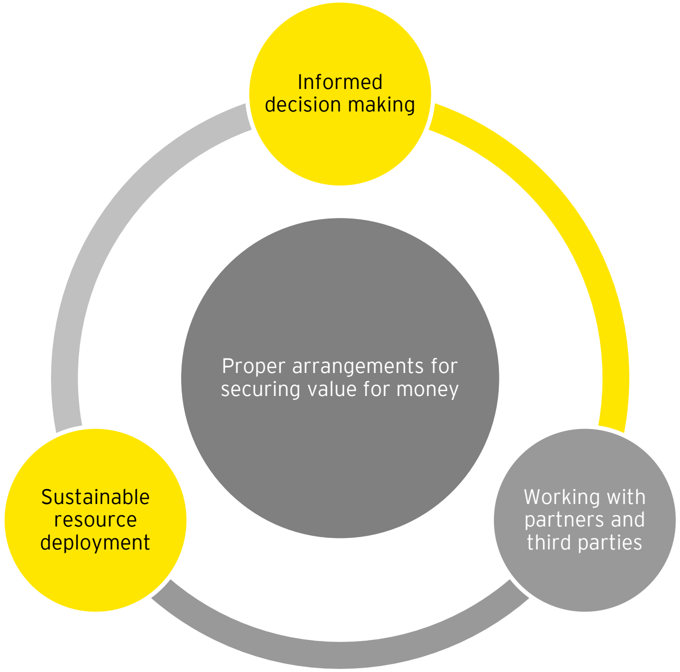
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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 2019/20 this has included consideration of the steps taken by the Council to consider the impact of Brexit and Covid-19 on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Councils will be carrying out scenario planning and that Brexit and Covid-19 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 is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
<u>Working with partners and other third parties</u> Working with third parties effectively to deliver strategic priorities.	<u>Results of regulatory reviews and commentary</u> During June 2019, Ofsted and the Care Quality Commission (CQC) conducted a joint inspection of the local Derby area to judge the effectiveness of the area in implementing the disability and special educational needs (SEND) reforms. The inspection raised significant concerns about the effectiveness of the local area and a written statement of action to Ofsted that explains how the local area will tackle the following areas of significant weakness is to be submitted: ▸ the failure of the local area to take the joint commissioning actions required to implement the reforms across education, health and social care; ▸ the lack of an overarching coproduced strategy for improving provision for and outcomes of children and young people with SEND; ▸ the number of significant weaknesses in the EHC processes, timeliness, quality and outcomes of plans; ▸ the long-standing systemic issues with waiting times to access a large number of key services; ▸ poor parental engagement with plans for local area SEND provision and high levels of parental dissatisfaction. The joint report of OFSTED and the CQC issued 19 August 2019 highlight significant weaknesses which indicates a significant risk to the VFM conclusion in terms of working with third parties effectively to deliver strategic priorities.	We will focus on: ▸ Obtaining a copy of the Council's written statement to the inspectorate; and ▸ Discussing with Officers the actions taken and future plans to address the areas of weakness in the joint report.

Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Sustainable resource deployment Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.	From the medium term financial strategy (MTFS), updated in February 2020, the Council has identified it will experience budget gaps across the next three years ranging from £3.1m in 2021/22 and decreasing to £2.9m in 2022/23. The proposed saving planned over the three years total £8.8m, with £4.7m planned in 2020/21. A one off £2.7m use of reserves is to be utilised to fund the collection fund deficit in 2020/21. Going forward the Council will need to reassess its financial strategy in light of Covid-19 and the impact to its financial plans, to achieve budget savings in order maintain delivery of Council services, and to enable it to hold an adequate level of useable reserves.	We will focus on: ▸ Monitoring the financial position for the remainder of 2019/20, including delivery against both revenue and capital challenges; ▸ Reviewing the MTFS including the adequacy of major assumptions; ▸ Reviewing the Council's arrangements to develop a robust savings plan to address the future financial challenges, including Covid-19.
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. In 2018/19, we reported the project had been subject to substantial overspend, which highlighted reporting and control issues. This provided evidence of weaknesses in proper arrangements for informed decision making, sustainable resource deployment and working with partners and other third parties. Assembly rooms - The latest projections show that the project will now cost £30 million, £6 million more than the £24 million budget, calling into question the sustainability and viability of the business case for a renewed Assembly Rooms. Work on the project has now been stopped while an in-depth evaluation takes place and consideration is given to the appropriate next steps and the options going forward. We will continue to monitor progress of the A52 improvement project and the assembly rooms in 2019/20.	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. ▸ Identify and assess management's plan of action in response to the financial implications stemming from the projected overspend and delivery of key priorities.

Value for Money Risks

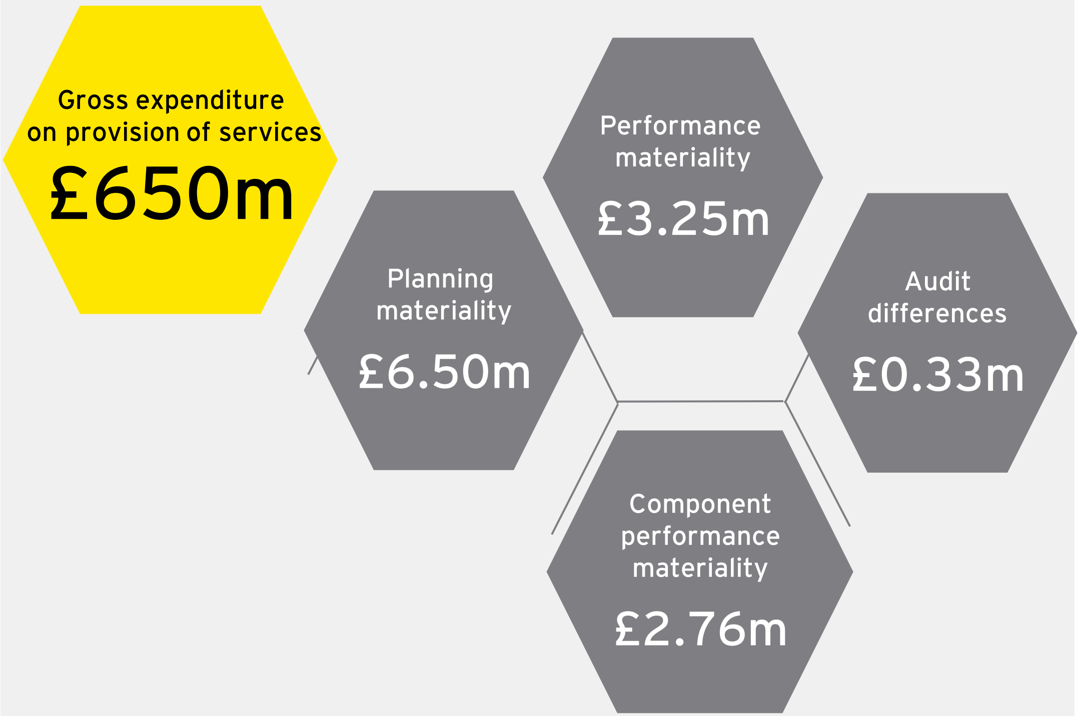
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
<u>Informed Decision Making</u> Managing and utilising assets effectively to support the delivery of strategic priorities.	<u>Sinfin Waste Management</u> Derby City Council and Derbyshire County Council contracted with Resource Recovery Solutions Derbyshire (RRS) to manage the Sinfin Waste Plant. The waste treatment centre was due to open in Sinfin in 2017, but RRS has been unable to resolve ongoing issues that would allow the facility to pass the certified performance tests required to bring it into full service. In April, the two councils issued a formal notice to the project's funders to take action under the contract to progress the project. The agreement with RRS to manage the Sinfin Waste Plant was cancelled in August 2019 when the banks funding the project issued a legal notice. The Councils are currently in a 6 stage process to assess the options available.	Our approach will focus on: ▸ Discussions with the Council Officers to understand the assessment undertaken and planned course of action. ▸ Review the decision making process followed the councils constitution.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2019/20 has been set at £6.50m for the Group and £6.55m 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 C.



We request that the Audit and Accounts Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £3.28m 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) £2.76m
- 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.

Specific materiality – We will set a lower materiality for remuneration disclosures, related party transactions, members' allowances and exit packages which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. **Financial statement audit**

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

2. Arrangements for securing economy, efficiency and effectiveness (value for money)

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2019/20 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics:
We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit Committee.

Internal audit:
We will regularly meet with the Head of Internal Audit, and review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.

Scoping the group audit

Group scoping

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

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

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

Scoping by Entity

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

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

Use of specialists

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

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

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 2019/20.

From time to time matters may arise that require immediate communication with the Audit and Accounts Committee and we will discuss them with the Audit and Accounts Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

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

2) MHCLG have changed the financial reporting dates in light of Covid-19. the Authority is now required to publish its draft statements by the 31 August (from 31 May) and publish audited accounts (where they have been audited) by 30 November (from 31 July).

The timeline takes advantage of the MHCLG flexibilities, however we are aware that these dates may be subject to further change as a result of the unforeseen challenges caused by COVID-19.

Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug

Stage	Description
Planning	Risk assessment and setting of scopes
Walkthroughs	Walkthrough of key systems and processes
Interim Audit	Early substantive testing
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

Deliverable	Description
Audit Plan (July)	Reporting our independence, risk assessment, planned audit approach and the scope of our audit
Audit Results Report (September)	Reporting our conclusions on key judgements and estimates and confirmation of our independence
Annual Audit Letter (TBC)	The Annual Audit Letter will be provided following completion of our audit procedures

08 Independence

Introduction

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

Required communications	
Planning stage	**Final stage**
▸ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence. ▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard [note: additional wording should be included in the communication reflecting the client specific situation]	▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▸ Written confirmation that all covered persons are independent; ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements , the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

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

Relationships, services and related threats and safeguards

Overall Assessment

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

Other threats

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

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

New UK Independence Standards

The Financial Reporting Council (FRC) published the Revised Ethical Standard 2019 in December and it will apply to accounting periods starting on or after 15 March 2020. A key change in the new Ethical Standard will be a general prohibition on the provision of non-audit services by the auditor (and its network) which will apply to UK Public Interest Entities (PIEs). A narrow list of permitted services will continue to be allowed.

Summary of key changes

- Extraterritorial application of the FRC Ethical Standard to UK PIE and its worldwide affiliates
- A general prohibition on the provision of non-audit services by the auditor (or its network) to a UK PIE, its UK parent and worldwide subsidiaries
- A narrow list of permitted services where closely related to the audit and/or required by law or regulation
- Absolute prohibition on the following relationships applicable to UK PIE and its affiliates including material significant investees/investors:
    - Tax advocacy services
    - Remuneration advisory services
    - Internal audit services
    - Secondment/loan staff arrangements
- An absolute prohibition on contingent fees.
- Requirement to meet the higher standard for business relationships i.e. business relationships between the audit firm and the audit client will only be permitted if it is inconsequential.
- Permitted services required by law or regulation will not be subject to the 70% fee cap.
- Grandfathering will apply for otherwise prohibited non-audit services that are open at 15 March 2020 such that the engagement may continue until completed in accordance with the original engagement terms.
- A requirement for the auditor to notify the Audit Committee where the audit fee might compromise perceived independence and the appropriate safeguards.
- A requirement to report to the audit committee details of any breaches of the Ethical Standard and any actions taken by the firm to address any threats to independence. A requirement for non-network component firm whose work is used in the group audit engagement to comply with the same independence standard as the group auditor. Our current understanding is that the requirement to follow UK independence rules is limited to the component firm issuing the audit report and not to its network. This is subject to clarification with the FRC.

Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under FRC Revised Ethical Standard 2016 which will continue to apply until 31 March 2020 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 1 April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.

We do not provide any non-audit services which would be prohibited under the new standard.

Other communications

EY Transparency Report 2019

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

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year end 30 June 2019:

https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/$FILE/ey-uk-2019-transparency-report.pdf

09 Appendices

Appendix A

Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2019/20 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.

We have communicated to the Authority, the scale fee will be impacted by a range of factors which will result in additional work. The Council have not agreed our estimated variation to the scale fee of £155,117 but understand that we are submitting our fee estimate to PSAA to determine the 2019-2020 audit fee. Our assessment is that the scale fee for the PC / CC should be increased from £109,766 to £264,883. This fee estimate does not take account of the additional audit procedures we consider necessary to respond to the financial reporting and value for money risks arising from Covid-19.

	Planned fee 2019/20	Scale fee 2019/20	Final Fee 2018/19
	£	£	£
Total Fee – Code work	109,766	109,766	109,766
Increase in scale fee/scale fee Variation	155,117 (Note 2)	0	42 000 (note 1)
Total audit	264,883	109,766	151,766
Housing Benefit Subsidy Claim	20,846	0	20.846
Teacher's Pension Audit	6,000	0	6,000
Pooling of Housing Capital Receipts	4,500	0	4,500
Total other non-audit services **	31,346	0	31,346
Total fees (exclude VAT)	296,229	109,766	183,112

(Note 1) an additional fee of £42,000 against the scale fee, for out of scope work carried out during 2018-19, was agreed with management to address value for money risks, implementation of IFRS 9 / 15, use of EY real estates, group accounts and the McCloud issue and are awaiting approval from PSAA.

(Note 2) The issues we have identified at the planning stage which will impact on the fee include:

- additional Financial Statement Risks
- additional Value for Money Risks
- additional work as a result of status as Major Local Audit
- additional work as a result of group accounts
- costs associated with professional and regulatory compliance changes including additional property valuation requirements and additional pension requirements
- technology and preparedness costs

Further details are set out in pages 41 and 42.

In addition, we are driving greater innovation in the audit through the use of technology. The significant investment costs in this global technology continue to rise as we seek to provide enhanced assurance and insight in the audit

- The 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.

Fees (continued)

We do not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity. For an organisation such as the council the extent of audit procedures now required mean it will take 2700-2800 hours to complete a quality audit. A commercial benchmark for this size of external audit would be in the region of £270,000.

Summary of key factors

1. **Status of sector.** Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, speculative ventures and investments. This has also brought increasing risk about the financial sustainability / going concern of bodies given the current status of the sector.

    - To address this risk our procedures now entail higher samples sizes of transactions, the need to increase our use of analytics data to test more transactions at a greater level of depth. This requires a continual investment in our data analytics tools and audit technology to enhance audit quality. This also has an impact on local government with the need to also keep pace with technological advancement in data management and processing for audit.

2. **Audit of estimates.** There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.

    - To address these findings, our required procedures now entail higher samples sizes, increased requirements for corroborative evidence to support the assumptions and use of our internal specialists.

3. **Regulatory environment.** Other pressures come from the changing regulatory landscape and audit market dynamics:

    - Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.

    - This means continual investment in our audit quality infrastructure in response to these regulatory reviews, the increasing fines for not meeting the requirements plus changes in auditing and accounting standards. As a firm our compliance costs have now doubled as a proportion of revenue in the last five years. The regulatory lens on Local Audit specifically, is greater. We are three times more likely to be reviewed by a quality regulator than other audits, again increasing our compliance costs of being within this market.

Appendix A

Fees (continued)

Summary of key factors (cont'd)

4. As a result Public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

   - We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality.

   - We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.

Next steps

- In light of recent communication from PSAA, we have quantified the impact of the above and accurately re-assessed what the baseline fee should be for the council in the current environment. The Council have not agreed our estimated variation to the scale fee but understand that we are submitting our fee estimate to PSAA to determine the 2019-2020 audit fee. This fee estimate does not take account of the additional audit procedures we consider necessary to respond to the financial reporting and value for money risks arising from Covid-19.

Appendix B

Required communications with the Audit Committee

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

Required communications	What is reported?	Our Reporting to you: When and where
Terms of engagement	Confirmation by the Audit and Accounts Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Planning Report – July 2020
Significant findings from the audit	▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ Significant difficulties, if any, encountered during the audit ▸ Significant matters, if any, arising from the audit that were discussed with management ▸ Written representations that we are seeking ▸ Expected modifications to the audit report ▸ Other matters if any, significant to the oversight of the financial reporting process	Audit Results Report – date to be confirmed

Appendix B

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements	Audit Results Report – date to be confirmed
Misstatements	▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ Corrected misstatements that are significant ▶ Material misstatements corrected by management	Audit Results Report – date to be confirmed
Fraud	▶ Enquiries of the Audit and Accounts Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▶ A discussion of any other matters related to fraud	Audit Results Report – date to be confirmed
Related parties	▶ Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the entity	Audit Results Report – date to be confirmed

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 July 2020 Audit Results Report – date to be confirmed

Appendix B

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report – date to be confirmed
Consideration of laws and regulations	▸ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▸ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	Audit Results Report – date to be confirmed
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit Results Report – date to be confirmed
Group audits	▸ An overview of the type of work to be performed on the financial information of the components ▸ An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ▸ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ▸ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ▸ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Audit Planning Report July 2020 Audit Results Report – date to be confirmed

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report – date to be confirmed
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report – date to be confirmed
Auditors report	▶ Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report – date to be confirmed
Fee Reporting	▶ Breakdown of fee information when the audit plan is agreed ▶ Breakdown of fee information at the completion of the audit ▶ Any non-audit work	Audit Planning Report July 2020 Audit Results Report – date to be confirmed

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	▸ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. ▸ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. ▸ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. ▸ Concluding on the appropriateness of management's use of the going concern basis of accounting. ▸ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. ▸ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the **Audit Committee** reporting appropriately addresses matters communicated by us to the **Audit Committee** and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▸ Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

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

Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the Group financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.