

Derby City Council

Year ending 31 March 2017

Audit Plan

19 September 2017

Ernst & Young LLP



Building a better
working world

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

19 September 2017

Dear Committee Members

Audit Plan

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit & Accounts Committee with a basis to review our proposed audit approach and scope for the 2016/17 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

We welcome the opportunity to discuss this Audit Plan with you on 19 September 2017 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

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

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The ‘Terms of Appointment from 1 April 2015’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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

1. Overview

This Audit Plan covers the work that we plan to perform to provide you with:

- ▶ Our audit opinion on whether the financial statements of Derby City Council give a true and fair view of the financial position as at 31 March 2017 and of the income and expenditure for the year then ended;
- ▶ Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness;

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

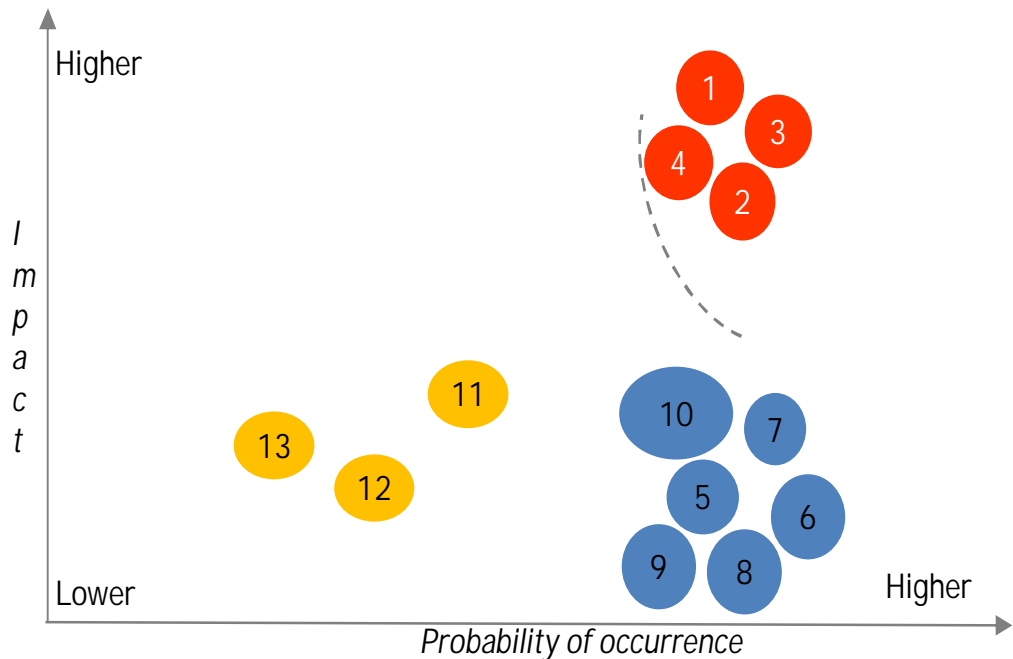
Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

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

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

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

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



Significant risks - financial statements (Section 2)

- 1 Valuation of Property, Plant & Equipment
- 2 Risk of fraud in expenditure recognition
- 3 Risk of management override
- 4 Private Finance Initiative (PFI) schemes



Significant risks - Value for Money (Section 3)

- 5 June 2016 public interest report
- 6 July 2017 written recommendations under Local Audit and Accountability Act 2014
- 7 Robustness of medium term financial planning
- 8 Provision of internal audit services
- 9 Results of regulatory reviews and commentary
- 10 Absence of corporate risk strategy and risk register



Other risks (Section 2)

- 11 Valuation of Pension scheme assets and liabilities
- 12 Change in Minimum revenue provision (MRP) policy
- 13 Restatement of the comprehensive income and expenditure statement

2. Financial statement risks

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

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

| Significant risks (including fraud risks) | Our audit approach |
|---|--|
| Valuation of Property, Plant & Equipment | |
| <p>Land and buildings is the most significant balance in the Council's Statement of Financial Position.</p> <p>The valuation of land and buildings is subject to a number of assumptions and judgements and even a small movement in these assumptions, could have a material impact on the accounts.</p> | <p>We will:</p> <ul style="list-style-type: none"> ▶ review the basis of asset revaluations undertaken and in doing so consider: <ul style="list-style-type: none"> ▶ the judgements, assumptions and data used; ▶ the reasonableness of estimation techniques applied; and ▶ the expertise of your valuation experts. ▶ review the accounting entries made to recognise the valuation changes in the accounts. ▶ make use of our valuation experts as appropriate. |
| Risk of fraud in revenue recognition | |
| <p>Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue.</p> <p>In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>For Derby City Council we consider that this risk presents itself in Fees, Charges and Other Service Income and Other Service Expenditure.</p> | <p>We will</p> <ul style="list-style-type: none"> ▶ Review and test revenue and expenditure recognition policies ▶ Review and discuss with management any accounting estimates on revenue or expenditure recognition for evidence of bias ▶ Develop a testing strategy to test material revenue and expenditure streams ▶ Review and test revenue cut-off at the period end date |
| Risk of management override | |
| <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p> <p>For local authorities, the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override.</p> | <p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements ▶ Reviewing accounting estimates for evidence of management bias, and ▶ Evaluating the business rationale for significant unusual transactions ▶ Review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised. ▶ Reviewing the accounting adjustments processed and disclosed in the Movement in Reserves Statement and supporting notes |
| Private Finance Initiative (PFI) Arrangements | |
| <p>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.</p> | <p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Obtaining and documenting an understanding of the schemes ▶ Considering whether the scheme falls within IFRIC 12 and should be accounted for on balance sheet ▶ Using our PFI specialists to consider whether the accounting model reflects the operator's model and produces reliable results for the financial statements ▶ Ensuring the outputs from the accounting model are correctly reflected in the financial statements, and relevant disclosures have been made |

Other financial statement risks

Accounting for Pension Liability

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

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

Our approach will focus on:

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

Change in Minimum Revenue Provision policy

Minimum Revenue Provision (MRP) is a statutory requirement to make a charge to the Council's General Fund to make provision for the repayment of the Council's past capital debt and other credit liabilities. The Council has set aside from revenue a minimum revenue provision of £11.4mn for the year ended 31 March 2017 (£10.9mn for the year ended 31 March 2016). In 2015/16 the Council made a change to their MRP policy which was reviewed and discussions identified that further opportunities existed to amend that policy in line with Regulation. The Council therefore had Arlingclose, their treasury management advisors, review their overall position with a view to making recommendations as to how the approach could be beneficially amended within the Regulations. Following the review the Minimum Revenue Provision policy, has been further updated, and applied from 1 April 2016.

Our approach will focus on:

- ▶ Using our in-house MRP specialist to perform a review of the Council's amended approach to calculating MRP.
- ▶ Reviewing the Council's model for MRP calculation to confirm that it was consistent with the Regulations.

Financial statements presentation – Expenditure and funding analysis and Comprehensive income and expenditure statement

Amendments have been made to the *Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the code)* this year changing the way the financial statements are presented.

The new reporting requirements impact the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS), and include the introduction of the new 'Expenditure and Funding Analysis' note as a result of the 'Telling the Story' review of the presentation of local authority financial statements.

The Code no longer requires statements or notes to be prepared in accordance with SeRCOP. Instead the Code requires that the service analysis is based on the organisational structure under which the authority operates. We expect this to show the Council's segmental analysis.

This change in the code will require a new structure for the primary statements, new notes and a full retrospective restatement of impacted primary statements. The restatement of the 2015/16 comparatives will require audit review, which could potentially incur additional costs, depending on the complexity and manner in which the changes are made.

Our approach will focus on:

- ▶ Review of the expenditure and funding analysis, CIES and new notes to ensure disclosures are in line with the code
- ▶ Review of the analysis of how these figures are derived, how the ledger system has been re-mapped to reflect the Council's organisational structure and how overheads are apportioned across the service areas reported.
- ▶ Agreement of restated comparative figures back to the Council's segmental analysis and supporting working papers.

2.1 Responsibilities in respect of fraud and error

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

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

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

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

3. Value for money risks

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.
For 2016-17 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.

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

| Significant value for money risks | Our audit approach |
|--|---|
| 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 2016/17 year of account. This report, and the Council's response to it therefore presents a significant risk to our VFM conclusion in terms of 'proper arrangements for informed decision making – by acting in the public interest, through demonstrating and applying the principles and values of sound governance'. | <p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Reviewing details of Public interest report and consider points within that relate to the 16/17 year of account. ▶ Reviewing the Council's progress towards addressing the points raised in the public interest report. |
| 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 | <p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ Reviewing the action plan created by the Council to address the issues raised in the written recommendations; and |

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.

This therefore presents a significant risk to our VFM conclusion in terms of:

- ▶ 'sustainable resource deployment - Managing and utilising assets effectively to support the delivery of strategic priorities'; and
- ▶ 'proper arrangements for informed decision making - Managing risks effectively and maintaining a sound system of internal control'

- ▶ Monitoring progress against that action plan.

Robustness of medium term financial planning

The Council's Medium Term Financial Plan and planning process is not sufficiently robust. Savings targets are 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.

This therefore presents a significant risk to our Value For Money conclusion in terms of 'sustainable resource deployment - Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions'.

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 the 15-16 position
- ▶ Evaluate the impact of any audit findings on the reported financial position.

Provision of internal audit services

EY have attended all audit committee meetings held throughout the 16-17 reporting period. In our view, 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 is often weak. We have not seen evidence of Officers being held to account for issues highlighted in internal audit reports but not addressed in a timely manner, nor evidence of challenge where risks are considered 'acceptable' by Officers. In early 2017 the Council have initiated a review of the internal audit service offering, and a number of weaknesses have been identified which have led to a transformation programme being initiated.

We therefore believe that there is a significant risk to our VFM conclusion in terms of 'working with partners and other third parties -Working with third parties effectively to deliver strategic priorities.'

Our approach will focus on:

- ▶ Reviewing the findings of the independent review of the internal audit service provision; and
- ▶ Monitoring the implementation of the transformation programme.

Results of regulatory reviews and commentary

The Council has received various commentary throughout the year from regulatory bodies, the tone of which has been mixed. Recent 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 indicate a significant risk to our VFM conclusion in terms of 'Working with third parties effectively to deliver strategic priorities'

Our approach will focus on:

- ▶ Discussions with Council Officers on actions taken to address the issues raised by Ofsted and the LGA peer review.

Absence of corporate risk strategy and risk register

There was no corporate risk strategy in place that covered 2016/17. The draft strategic risk register went to Chief Officer Group in November 2015, as a working copy for them to comment on. It was agreed that a clearer definition of the risk appetite and what would and would not be tolerated was needed. At September 2017, the new strategy document was still in the process of being redrafted.

This presents a significant risk in respect of the Council's arrangements for managing risks effectively, and the ability to make informed decisions.

Our approach will focus on:

- Understanding the progress made by the Council to prepare and embed a corporate risk strategy and risk management process.

4. Our audit process and strategy

4.1 Objective and scope of our audit

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

- ▶ Financial statements
- ▶ Arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. Financial statement audit

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

We report to you by exception in respect of your governance statement and other accompanying material as required, in accordance with relevant guidance prepared by the NAO on behalf of the Comptroller and Auditor General.

Alongside our audit report, we also:

- ▶ Review and report to the NAO on the Whole of Government Accounts return to the extent and in the form they require;
- 2. **Arrangements for securing economy, efficiency and effectiveness (value for money)**

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

4.2 Audit process overview

Processes

A key consideration in our audit planning process is the effectiveness of entity level controls; including the extent to which the Council assesses risk, implements controls in order to minimise risk and performs ongoing testing and monitoring of the effectiveness of the controls implemented. Our initial risk assessment has highlighted a significant risk over the control environment at the council as noted at section 3 above, in light of the significant risk identified we will be undertaking a substantive approach to our audit of the accounts.

Analytics

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

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

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

Internal audit

As in prior years, we will review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan where we identify issues that could have an impact on the year-end financial statements

Use of specialists

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

| Area | Specialists |
|---|--|
| Property, Plant & Equipment | Council's valuation team Cushman and Wakefield Innes England EY valuations team |
| Defined Benefit Pension Scheme assets and liabilities | Pension scheme actuary EY Pensions team |
| Private Finance Initiative (PFI) schemes | EY PFI specialist |
| Fair Value Disclosures and Minimum Revenue Provision | Arlingclose |
| IT environment | EY IT risk team |

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's environment and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- ▶ Analyse source data and make inquiries as to the procedures used by the expert to establish whether the source data is relevant and reliable;
- ▶ Assess the reasonableness of the assumptions and methods used;
- ▶ Consider the appropriateness of the timing of when the specialist carried out the work; and
- ▶ Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

4.3 Mandatory audit procedures required by auditing standards and the Code

As well as the financial statement risks (section two) and value for money risks (section three), we must perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

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

Procedures required by the Code

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

Other procedures

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

4.4 Materiality

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

We have determined that overall materiality for the financial statements of the [Council](#) is £6.933m based on 1% of gross expenditure. We will communicate uncorrected audit misstatements greater than £0.345m to you.

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

4.5 How materiality is applied to the component locations

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

To achieve this, we assign a materiality level to component teams to use when designing their audit procedures. We determine component materiality as a percentage of Group materiality based on risk and relative size to the Group. Based on the planning materiality of £6.9 million, we have assigned 30% to Derby Homes Limited. The component reporting limit for adjustments of £345k is the same as that noted above.

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

4.6 Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code. The indicative fee scale for the audit of Derby City Council is £142,553.

4.7 Your audit team

The engagement team is led by Steve Clark, who has significant experience of local authority audits. Steve is supported by Helen Henshaw, a Senior Manager who is responsible for the day-to-day direction of audit work and is the key point of contact for the Director of Finance.

4.8 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit, including the value for money work and the Whole of Government Accounts. The timetable includes the deliverables we have agreed to provide to the Council through the Audit & Accounts Committee's cycle in 2016/17

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

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

| Audit phase | Timetable | Audit and Accounts Committee timetable | Deliverables |
|---|---------------|--|---|
| High level planning , Risk assessment and setting of scopes | January 2017 | | |
| Testing routine processes and controls | March 2017 | September 2017 | Audit Plan |
| Year-end audit | October 2017 | | |
| Completion of audit | November 2017 | December 2017 | Report to those charged with governance via the Audit Results Report Audit report (including our opinion on the financial statements and overall value for money conclusion. Audit completion certificate Reporting to the NAO on the Whole of Government Accounts return. |
| Conclusion of reporting | January 2018 | January 2018 | Annual Audit Letter |

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

5. Independence

5.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 260 'Communication of audit matters with those charged with governance', requires us to communicate with you on a timely basis on all significant facts and matters that bear on our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we do this formally both at the planning stage and at the conclusion of the audit, as well as during the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

| Required communications | |
|--|---|
| Planning stage | Final stage |
| <ul style="list-style-type: none"> ▶ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between you, your affiliates and directors and us; ▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality Review; ▶ The overall assessment of threats and safeguards; ▶ Information about the general policies and process within EY to maintain objectivity and independence. | <ul style="list-style-type: none"> ▶ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▶ Details of non-audit services provided and the fees charged in relation thereto; ▶ Written confirmation that we are independent; ▶ Details of any inconsistencies between APB Ethical Standards, the PSAA Terms of Appointment and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ▶ An opportunity to discuss auditor independence issues. |

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, for example when accepting an engagement to provide non-audit services.

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

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

5.2 Relationships, services and related threats and safeguards

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

Self-interest threats

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with the Council.

At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services, and we will comply with the policies that the Council has approved and that are in compliance with PSAA Terms of Appointment.

At the time of writing, the current ratio of non-audit fees to audit fees is approximately 24:1. 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 the Council. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in compliance with Ethical Standard 4.

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

Self-review threats

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

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

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions based on that work.

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

Other threats

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

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

Overall Assessment

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

5.3 Other required communications

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

Details of the key policies and processes within EY for maintaining objectivity and independence can be found in our annual Transparency Report, which the firm is required to publish by law. The most recent version of this report is for the year ended June 2016 and can be found here:

<http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2016>

Appendix A Fees

A breakdown of our agreed fee is shown below.

| | Planned Fee 2016/17 £ | Scale fee 2016/17 £ | Outturn fee 2015/16 £ | Explanation |
|--|-----------------------------|---------------------------|-----------------------------|---|
| Opinion Audit and VFM Conclusion | 142,553 ¹ | 142,553 | 400,000 | 2015/16 proposed fee subject to PSAA approval |
| Total Audit Fee – Code work | 142,553 | 142,553 | 400,000 | |
| Certification of claims and returns ² | 15,780 | 19,725 | 20,846 | Change in scope, additional work completed by council therefore planned fee includes reduction agreed of £3,945 |
| Non-audit work | - | - | 3,000 | Teachers' pension and Capital pooling returns |

All fees exclude VAT.

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

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

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

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

- ▶ Ineffective internal controls noted in section 4.2 above
- ▶ Additional audit procedures required in respect of the valuation of property, plant and equipment
- ▶ Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.
- ▶ Change in scope of the audit with respect to Derby Homes Limited.

¹ Subject to additional audit work which will be necessary.

² Our fee for the certification of grant claims is based on the indicative scale fee set by the PSAA.

Appendix B UK required communications with those charged with governance

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

| Required communication | Reference |
|--|------------------------|
| Planning and audit approach Communication of the planned scope and timing of the audit including any limitations. | ► Audit Plan |
| Significant findings from the audit <ul style="list-style-type: none"> ► Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ► Significant difficulties, if any, encountered during the audit ► Significant matters, if any, arising from the audit that were discussed with management ► Written representations that we are seeking ► Expected modifications to the audit report ► Other matters if any, significant to the oversight of the financial reporting process | ► Audit Results Report |
| Misstatements <ul style="list-style-type: none"> ► Uncorrected misstatements and their effect on our audit opinion ► The effect of uncorrected misstatements related to prior periods ► A request that any uncorrected misstatement be corrected ► In writing, corrected misstatements that are significant | ► Audit Results Report |
| Fraud <ul style="list-style-type: none"> ► Enquiries of the Audit & Accounts Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ► Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ► A discussion of any other matters related to fraud | ► Audit Results Report |
| Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable: <ul style="list-style-type: none"> ► Non-disclosure by management ► Inappropriate authorisation and approval of transactions ► Disagreement over disclosures ► Non-compliance with laws and regulations ► Difficulty in identifying the party that ultimately controls the entity | ► Audit Results Report |
| External confirmations <ul style="list-style-type: none"> ► Management's refusal for us to request confirmations ► Inability to obtain relevant and reliable audit evidence from other procedures | ► Audit Results Report |
| Consideration of laws and regulations <ul style="list-style-type: none"> ► Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ► Enquiry of the Audit & Accounts Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit & Accounts Committee may be aware of | ► Audit Results Report |

| Required communication | Reference |
|---|---|
| Independence Communication of all significant facts and matters that bear on EY's objectivity and independence Communication of key elements of the audit engagement director's consideration of independence and objectivity such as: <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence | <ul style="list-style-type: none"> ▶ Audit Plan ▶ Audit Results Report |
| Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements | <ul style="list-style-type: none"> ▶ Audit Results Report |
| Significant deficiencies in internal controls identified during the audit | <ul style="list-style-type: none"> ▶ Audit Results Report |
| Fee Information <ul style="list-style-type: none"> ▶ Breakdown of fee information at the agreement of the initial audit plan ▶ Breakdown of fee information at the completion of the audit | <ul style="list-style-type: none"> ▶ Audit Plan ▶ Audit Results Report ▶ Annual Audit Letter if considered necessary |
| Group audits <ul style="list-style-type: none"> ▶ An overview of the type of work to be performed on the financial information of the components ▶ An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ▶ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ▶ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ▶ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements | <ul style="list-style-type: none"> ▶ Audit Plan ▶ Audit Results Report |
| Certification work <ul style="list-style-type: none"> ▶ Summary of certification work undertaken | <ul style="list-style-type: none"> ▶ Certification Report ▶ Annual Audit Letter if considered necessary |

Appendix C Detailed scopes

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

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

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

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

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

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

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

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