Derby City Council

External Audit Progress Report
for the year ended 31 March 2016

23 September 2016

Ernst & Young LLP

Building a better
working world

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Contents

In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ''Statement of responsibilities of auditors and audited bodies 2015-16'. It is available from the Chief Executive of each audited body and via the PSAA website (www.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 Results Report is prepared in the context of the Statement of responsibilities. This report is intended solely for the use of the Members 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. Executive summary

The National Audit Office's Code of Audit Practice (the Code) requires us to report to those charged with governance – the Audit Committee – on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified.

This report summarises our progress to date in performing the audit of the draft 2015/16 financial statements. It includes messages arising from our audit of your financial statements and the results of the work we have undertaken to assess your arrangements to secure economy, efficiency and effectiveness in your use of resources.

Status of the audit	Our audit of the draft financial statements is ongoing. The most significant outstanding items are included in Appendix D. Of most significance in terms of the timing of completion is the need for the Council to review its underlying PPE records and ensure these are complete, accurate, the assets exist and are valued appropriately and that these records match the financial ledger. Issues with respect to the valuation of Property, Plant and Equipment have also meant that the Council failed to meet its statutory obligation to prepare draft financial statements by 30 June 2016. The draft financial statements were approved by the s.151 Officer on 25 July 2016 (just over three weeks after the deadline) and the required period of public inspection was commenced and published on the Council's website. The Council therefore failed to meet the statutory requirement for the inspection period to include the first 10 days of July. Given the significant work required to achieve this and the time taken to date, at this point, we would not envisage being able to complete the audit for at least a period of several weeks after the 30 September. We continue to perform the procedures outlined in our Audit Plan. In addition, we have needed to undertake further procedures in a number of areas in order to be able to obtain sufficient and appropriate audit evidence. At the time of writing, the nature of our opinion (i.e., qualified or unqualified) on the Authority's financial statements has not been determined. This is due to the significance of the issues encountered thus far, which are set out in more detail in the body of this progress report. We will conclude that the Council has not put in place proper arrangements to secure value for money in its use of resources. We have not yet performed the procedures required by the National Audit Office (NAO) regarding the Whole of Government Accounts submission. This work cannot be commenced until a final set of accounts subject to audit is presented to us. We expect to issue the audit certificate at the same time as the audit opinion.

Audit differences	We have identified at this stage several audit differences within the draft financial statements, some of which management have informed us that they do not wish to adjust for when they prepare the final version of the accounts. When the accounts are finalised, we will ask the Audit Committee to consider approving management's rationale as to why these corrections will not be made and, if approved, we will include this in the Letter of Representation which will be signed at a future date, when the final accounts are approved.
	
	Appendix A to this report sets out the misstatements that we have found to date. Many of the misstatements are in excess of planning materiality, and we continue to work through the process of validating them with management. We will continue to evaluate, both quantitatively and qualitatively, the misstatements in the financial statements as our audit progresses and Management prepare the revised financial statements.
	
	In addition to the misstatements we have found as a result of our audit procedures, in forming our audit opinion we also consider the risk of undetected misstatements. The qualitative factors that we consider when determining the risk of undetected misstatements include:
	
	► The number and monetary amounts of uncorrected and corrected misstatements identified, and
	► Whether the misstatements:
	  ► Relate to routine classes of transactions or to areas of estimation
	  ► Have arisen due to poor competence of the entity's personnel
	  ► Have arisen due to fraud or error

Scope and materiality	In our audit plan presented at the 23 March 2016 Audit Committee meeting, we communicated that our audit procedures would be performed using a materiality of £6.9mn. We have reassessed this based on the actual results for the financial year and there has been no change to the materiality level we have applied. The threshold for reporting audit differences which impact the financial statements has also

	not changed from £346k. The basis of our assessment is 1% of gross operating expenditure, to reflect the level of risk that we perceive to be inherent in the Council's financial statements.
Significant audit risks	We identified the following audit risks during the planning phase of our audit, and reported these to you in our audit plan: ► Valuation of property, plant and equipment; ► Risk of fraud in expenditure recognition; and ► Risk of management override. The 'addressing audit risks' section of this report sets out the progress we have made in addressing these risks, the audit assurance we have gained, and the issues identified.
Other reporting issues	Subsequent to the issue of our Audit Plan on 23 March 2016, Grant Thornton, our predecessor, used their statutory powers to issue a *Report in the Public Interest* on 16 June 2016. The report highlighted various matters of concern with respect to the Council's Governance arrangements (both historic and ongoing), Member/Officer relations, and Procurement and Project Management arrangements. Our audit approach has been responsive to the issues raised in Grant Thornton's report and the report will be specifically referenced in our Value for Money conclusion.
Control observations	As we noted in our Audit Plan, our intention was to test the internal controls in place at the Council and place reliance upon them. However, our initial procedures to document and understand the processes and controls in place at the Council highlighted some control weaknesses which we felt it appropriate to communicate to the Audit Committee at that time – and these were included in our Audit Plan. We have therefore adopted a fully substantive approach and have not tested the operation of controls. However, during the audit, we have identified a number of observations and improvement recommendations in relation to management's financial processes and controls. These are set out in the 'Control themes and observations' section of this report. In our view the most significant control weakness is the failure to complete and review account reconciliations on a timely basis

We would like to take this opportunity to thank the Council's staff for their continued assistance during the course of our work.

Stephen Clark
Partner
For and on behalf of Ernst & Young LLP

2. Responsibilities and purpose of our work

The Council's responsibilities

The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement (AGS). In the AGS, the Council reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Purpose of our work

Our audit is designed to:

- Express an opinion on the 2015/16 financial statements and the consistency of other information published with them;
- Report on an exception basis on the Annual Governance Statement;
- Consider and report any matters that prevent us being satisfied that the Council had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the value for money conclusion); and
- Discharge our statutory duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

In addition, this report contains our findings related to the areas of audit emphasis and any views on significant deficiencies in internal control or the Council's accounting policies and key judgments.

Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.

3. Financial statements audit

Addressing audit risks

We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan. Here, we set out how we have gained audit assurance over those issues.

A significant audit risk in the context of the audit of the financial statements is an inherent risk with both a higher likelihood of occurrence and a higher magnitude of effect should it occur and which requires special audit consideration. For significant risks, we obtain an understanding of the entity's controls relevant to each risk and assess the design and implementation of the relevant controls.

Significant Risk: Valuation of property, plant and equipment

Land and buildings is the most significant balance in the Council's Statement of Financial Position.

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.

Audit procedures performed

Our approach has focussed on:

- Using our EY valuation specialists to:
  - Understand and assess the process that the Council undertakes when valuing it's land and buildings, and the controls in place
  - Review (on a sample basis) the output of the Council's valuer
- Challenging the assumptions used by the Council's valuer by reference to external evidence and our EY valuation experts
- Testing the journals for the valuation adjustments to check that they have been accurately processed in the accounts

Assurance gained and issues arising

The Council has undertaken an extensive review of its asset valuations following concerns raised in the year by a whistle-blower. This work was the reason for the delay in issuing the draft financial statements, and failing to meet the 30 June 2016 statutory publication deadline.

Our EY valuation specialists have spent time with the Council's Estates team to understand the valuations methodologies adopted, and the systems and processes in place.

As a result of this initial work, we considered that the process for valuation of the Council's housing stock appeared to be thorough and robust. We do however note that the value of Council dwellings in the draft financial statements is £2mn higher than the Council's Estates team now believe that it should be, following their own validation of the asset values. We have tested, on a sample basis, these valuations back to supporting evidence and have no concerns to report.

The valuation of other property, plant and equipment is more complex. Consequently our EY valuations experts have performed a detailed review of an initial 29 asset valuations prepared by the Estates team in the current year. As a result of examining this small sample of assets, a number of issues have resulted:

Issue identified	Financial impact	Implications for the remainder of the Council's asset portfolio
The Assembly Rooms suffered a major fire on 14 March 2014. Almost a year later (5 March 2015) the Council took the decision that the venue would never reopen. This decision should have triggered an impairment review in respect of the value of the asset in the Council's accounts. It did not. At 31 March 2016 the Council valued the Assembly Rooms at £300k (an impairment of c.£37mn compared to the valuation at 31 March 2015). Two issues arise: 1. Appropriateness of the new valuation 2. Timing of the impairment	There are two implications of this issue: 1. The value of £300k for a prime City Centre site is, in our view, too low. Following discussion with the EY valuation experts, the Council have now agreed to increase the value of the Assembly Rooms at 31 March 2016 to £750k 2. The impairment in value has been recognised in the wrong year. The impairment should have been recognised in the 2014/15 financial statements. The prior year accounts were therefore materially misstated, and a prior period adjustment is required to correct the opening balance sheet position.	The Assembly Rooms fire was a significant event in Derby and received much press coverage at the time, and thereafter. The failure to impair the value of the Assembly Rooms in a timely manner following the fire illustrates a lack of thorough review for impairment indicators when preparing the asset valuations. This therefore raises a risk that additional assets within the Council's property portfolio are also valued incorrectly.
Given that the Assembly Rooms was specifically being considered in our sample of 29, we traced the valuation prepared by the Estates team through to the value of the asset held on the Council's fixed asset register (which in turn feeds the financial statements). We noted that the fixed asset register contained many individual line items with respect to the Assembly rooms (the restaurants beneath, etc.). The total value of all these line items in the fixed asset register did not agree to the value of the Assembly Rooms as determined by the Estates team.	The value of the Assembly Rooms on the fixed asset register was £1.2mn The value of the Assembly Rooms determined by the Council's Estates team was £300k	There are data validation issues between the fixed asset register and the valuations produced by the Council's Estates team which mean that they do not reconcile . The value of the Council's property, plant and equipment does not therefore correspond to the valuations arrived at by the Council's registered valuers in the Estates team. Until this issue is resolved, it is not possible for us, or the Council, to place any assurance on the value of the assets as included in the financial statements.
After observing the large number of items on the fixed asset register which related to the Assembly Rooms, we challenged why the Car Park was included at zero value. We were informed that this was an oversight on the Council's part.	The assets in the Council's draft balance sheet at 31 March 2016 are understated by the value of the Assembly Rooms Carpark, namely £3mn. Since the car park was also included at nil value in the prior year, the assets in the Council's balance sheet at 31 March 2015 were also understated.	The Council needs to undertake an exercise to review its asset portfolio for completeness to ensure that the valuations of other material assets are not omitted from the register and therefore not included in the financial statements.
Valuation of Parks We selected a number of items relating to parks and	The parks and open spaces included in the Council's draft financial statement are overstated by £5.6mn on	The Council needs to undertake an exercise to review its fixed asset register to gain assurance that all assets included in the register

Issue identified	Financial impact	Implications for the remainder of the Council's asset portfolio
assets held on parks in our sample. The Council's approach to valuing Parks is to do so by considering the individual 'components' that make up a Park (play equipment, ranger stations, etc.) and value these individually. By way of example, Markeaton Park has 78 assets listed separated into various components of land, buildings and equipment. The various components of the park do not meet the criteria for componentisation as they are not significant to the park in its entirety. Our view is that this is not best practice, and the park should be valued as a whole. When further examining the Parks value held on the Council's fixed asset register of (£26.3mn at 31 March 2016) we noted the following issues: 1. £5.6mn on the fixed asset register described as 'parks and open spaces'. The Council is unable to provide us with information as to which specific Parks/Open spaces this value relates to. 2. Play equipment held on the fixed asset register with an indefinite useful economic life – meaning that it is not being depreciated.	the basis that the Council cannot tell us where these parks/open spaces are. In our view, it is unreasonable to ascribe an indefinite useful economic life to park play equipment. The value of the equipment is £12.4mn. This results in an understatement to the annual depreciation charge, for the particular asset identified, of £1.2mn if you assume a more reasonable life of 10 years.	physically exist and are the property of the Council. The Council needs to undertake an exercise to review the useful economic lives assigned to assets in the fixed asset register to ensure that assets are depreciated appropriately. Furthermore, the Council should perform an exercise to determine what the cumulative charge for depreciation of play equipment would be to determine whether this is sufficiently material to warrant inclusion in the prior period adjustment.
Valuation of land with respect to Schools, libraries and leisure centres. In the draft financial statements, the Council has posted a £78mn prior period adjustment as a result of changing, during the 2015/16 financial year, the basis and methodologies employed for valuing the land elements of the land of some Council properties. These properties are predominantly schools but also include libraries and sports centres and many of these assets sit within residential areas. Previously the land element was valued based upon a nominal rate, however when adopting the modern equivalent approach the owner would need to compete for residential development land. This type of land will have a higher market price than the nominal rate previously used. Applying the change in valuation has resulted in a net revaluation gain of £78.183mn in 2014/15. The draft financial statements have been restated for consistency and to enable comparison between years. Valuations are, by nature, judgemental and we look for valuations to be within an acceptable range. In our view, the position taken by the Council is at the most aggressive	Still to be quantified.	In discussion with the EY Valuations team, the Council have committed to reconsidering the proportion of land which is valued at full residential value to fall more in line with peers.

<table>
<tr><th>Issue identified</th><th>Financial impact</th><th>Implications for the remainder of the Council’s asset portfolio</th></tr>
<tr><td>point of the valuation spectrum in this regard.

Guidance in this area is not clear. However, it is our understanding that the various interested parties are currently part of a working group to clarify guidance, and we would expect that clarification to be available within the next 12 months. We feel it is unlikely that the guidance would be set at the aggressive point of the range, and therefore the Council would need to reverse, at least in part, this upward valuation within the next 12-24 months.</td><td></td><td></td></tr>
<tr><td>Moorways sports complex

The Council took the decision to close the swimming pool to the public at Moorways, effective 31 March 2016. At the time of writing, we await confirmation that this decision has been appropriately factored in to the valuation ascribed to Moorways sports complex at 31 March 2016 (of £16.5mn.)</td><td></td><td>The Council should prepare, on an annual basis, a schedule of assets which have been subject to decisions or events which may have impaired their carrying value in the financial statements, such that these matters can be considered and evidenced as considered) when valuing the portfolio for inclusion in the annual financial statements.</td></tr>
<tr><td>Reasonableness of valuation assumptions applied.

There were a number of individual assets in our sample where the value determined by the Council’s Estates team was outside of the acceptable range in the view of EY valuation experts. These assets were:
1. Bold Lane Car Park
2. Ranger complex, chaddesden park
3. The Knoll site
4. Chester Park
5. Former tannery site
6. Jubilee park
7. Bull and Bush, Henley Green, Mackworth

Discussions have continued between the EY valuations experts and the Council’s Estates team and as a result, the Estates team propose amending the values attributed to these particular assets.</td><td>The adjustments required to the draft financial statements with regard to these particular assets are as follows:
<table>
<tr><th>Asset</th><th>Original 15/16 value £’000</th><th>Revised 15/16 value £’000</th></tr>
<tr><td>Bold lane car park</td><td>275</td><td>2,150</td></tr>
<tr><td>Chaddesden Park</td><td>148</td><td>644</td></tr>
<tr><td>Chester Park</td><td>605</td><td>725</td></tr>
<tr><td>Former tannery site</td><td>67</td><td>425</td></tr>
<tr><td>Jubilee park</td><td>530</td><td>558</td></tr>
<tr><td>Total</td><td>1,625</td><td>4,502</td></tr>
</table></td><td>The Council needs to assure itself that the Values assigned to assets within the fixed asset register are robust and stand up to scrutiny.</td></tr>
</table>

Issue identified	Financial impact	Implications for the remainder of the Council's asset portfolio
Deminimus assets At the 31 March 2015 the Council's accounting policy was to recognise as property, plant and equipment on the balance sheet if its value was in excess of £10k. However, an asset would only be included in the rolling asset valuation program if its value was in excess of £50k. This meant that there were many items on the asset register valued at between £10k and £50k which were not subject to review from a valuation perspective. For the year ended 31 March 2016 the Council has amended its policy. Property, Plant and Equipment is still recognised on the balance sheet if it is valued at over £10k, but now all assets are subject to revaluation on the rolling program.	Total value of assets valued at between £10,000 and £49,999 at 31 March 2016 is £11mn. There is a risk that this portion of the asset portfolio is undervalued.	The Council should complete a review of those assets whose individual value is less than £50k to assure itself that the value is free from material misstatement.
Annual review of asset lives. Assets lives not adequately reassessed on a yearly basis. During our sample for depreciation testing, we identified that 6 assets relating to buildings under the category 'Land and buildings' had a 1 year life span at the beginning of the period however additions were made during the year to the value of £4,889,625. The addition was fully depreciated in the 15/16 year due to 1 year life span at the beginning of the period. We are informed that the reassessment of the useful life will only be considered in a future financial period.	Subsequent information provided by Management indicates additional assets with this issue of £5mn (therefore £10mn of assets in total). We are unable to determine what the remaining useful life should have been reassessed to and are therefore unable to quantify the misstatement of depreciation. The Council's accounting policy states that buildings are depreciated over a period of 5 years to perpetuity. Depreciation charged in the year is therefore overstated by a maximum of £10mn.	Asset lives should be reviewed for appropriateness on an annual basis.
Derecognition of assets written out in the incorrect period. We identified that assets (photocopiers and vehicles) were recorded in the current year draft financial statements but should have been derecognised in prior period.	Opening balances of cost and accumulated depreciation for Vehicles, plant and equipment is overstated by £4.7mn.	The Council needs to undertake an exercise to review its fixed asset register to gain assurance that all assets included in the register physically exist and are the property of the Council.

In summary, the issues noted with respect to the Council's asset portfolio are extensive and exceed those which were originally highlighted by the whistleblower. A significant amount of work needs to be undertake by the Council to satisfy itself that the assets held on its balance sheet both at 31 March 2016 and 31 March 2015 are complete, exist, and are valued appropriately.

Significant Risk: Risk of management override

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.

For Derby City Council we consider that this risk presents itself in:

- The risk of inappropriate capitalisation of revenue expenditure
- The determination of accounting estimates
- The posting of manual journals to the general ledger

Audit procedures performed

Our approach has focused on:

- 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

Assurance gained and issues arising

We have used our data analytics tools to select specific journals for testing based on risk criteria. Our work in this area is substantially complete, and we have not identified any issues of management override.

We have reviewed significant accounting estimates for evidence of bias, with the following results:

Accounting estimate	Results of review
Valuation of property, plant and equipment	Refer to comments above.
Valuation of pension scheme assets and liabilities	Refer to comments below.
National Non-Domestic Rates Appeals Provision	The NNDR appeals provision is calculated by referencing the historic performance of successful appeals, the reduction in rateable value for these appeals and the length of backdating applied. For appeals received in the 2014/15 year, a different calculation has been used by the Council to reflect the fact that this was the final year before the VOA cut off. As such the amount of appeals lodged in 2014/15 is significantly higher but it is anticipated a higher proportion of these are more speculative, with a reduced chance of success. The Council has based its calculation on the historic performance from the last year preceding a VOA rating list cut off (2010/11). If the Council had used the average of the last 2 VOA cut-off years (2010/11 and 2005/06) then the impact on the provision for NNDR appeals would be to increase the provision by £2.7mn. Based on this work we conclude that the provision for NNDR appeals is understated by £2.7mn. We have included this on our schedule of unrecorded differences at Appendix A.

Accounting estimate	Results of review
Doubtful Debt Provision	When obtaining audit evidence in respect of the doubtful debt provision for Council Tax and National Non-Domestic Rates arrears we encountered the following issues: 1. Timeliness of working paper provision Working papers were not readily available to support the judgements made in arriving at the balances in the financial statements. 2. Use of historic data with no evidence of annual review and challenge When working papers were provided, the data and assumptions within them were out of date (over four years old) and there was no evidence that any review or challenge had been applied to this data to assess whether it remained relevant for the current year. 3. Lack of demonstrable evidence to support the working papers Working papers were not supported by evidence to demonstrate the appropriateness of assumptions and judgements being applied. **Council Tax Doubtful Debt Provision:** The collectability percentages assumed in the Council's calculation of doubtful debts with respect to Council Tax arrears are as follows: Current year – 98.4%, Year 1-60%, Year 2-30%, Year 3-20%, Year 4-10%. EY have recalculated the required provision based on collectability rates which from our experience are more typical of Councils who actively track collectability year on year: Current year 65%, Year 1-10%, Year 2 onwards- 0%. Based on this work we conclude that the provision for Council Tax doubtful debts is understated by £3.6mn. We have included this on our schedule of unrecorded differences at Appendix A. **NNDR Doubtful debt provision** The collectability percentages assumed in the Council's calculation of doubtful debts with respect to NNDR arrears are as follows: Year 1-80% collectability. Year 2 onwards – 5% collectability. The rate used for Year 2 onwards appears reasonable. However the rate assumed for Year 1 seems very high based on our experience of other local authorities. We examined the total NNDR debt outstanding in 2015/16 and 2014/15 to assess the movements year on year. Looking at the debt in 2014/15 there was £2.490mn relating to that year. By 2015/16 this debt was 1 year old and had decreased to £1.110mn. The decrease was £1.38mn over the year, meaning the collectability rate was 55%. As the debt gets older, the likelihood of collectability will decrease. We therefore believe that a collectability assumption of 80% for debt in year 1 seems too high. By assuming collectability of 55% in year 1, the provision is understated by £672k. We have included this on our schedule of unrecorded differences at Appendix A.
Equal Pay Provision	Refer to comments below.
Other Provisions	We have reviewed the 'other' provisions held by the Council at 31 March 2016 totalling £1.6mn and have found no evidence of management override.
Impairments	We have found evidence that the Council's processes for identifying impairment triggers have failed, as demonstrated by the failure to recognise the impairment in valuation of the Assembly Rooms in the correct financial period. We will continue our audit procedures with a view to determining whetherthere may have been other indicators of impairment in the period which have not been appropriately responded to.

Significant Risk: Risk of fraud in expenditure recognition
Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. 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. For Derby City Council we consider that this risk presents itself in other service expenses.

Audit procedures performed

Our approach has focussed on:

- ► Review and testing of revenue and expenditure recognition policies
- ► Review and discussing with management any accounting estimates on revenue or expenditure recognition for evidence of bias
- ► Developing a testing strategy to test material revenue and expenditure streams
- ► Review and testing revenue cut-off at the period end date
- ► Performing unrecorded liabilities testing

Assurance gained and issues arising

Our work in this area remains ongoing.

We also identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Plan.

Here, we set out how we have gained audit assurance over those issues.

Other Risks	Audit procedures performed	Assurance gained and issues arising
Valuation of Pension scheme assets and liabilities Funding of the Council's participation in the local government pension scheme will continue to have an impact on both Council cash flows and balance sheet liabilities. The pension liability is the most significant liability on the Council's balance sheet and is calculated through use of a number of actuarial assumptions. A small movement in these assumptions could have a material impact on the balance sheet.	Our approach has focussed on: ► Reviewing the output of the report from the Administering Council's actuary ► Reviewing the assumptions used by the actuary to determine whether they are in our expected range ► Testing the journal entries for the pensions transactions to check that they have been accurately processed in the accounts	Our work in this area remains ongoing.
Equal Pay Provision The Council's Equal Pay liability is a continuing challenge with £13mn included in the 2014/15 accounts which incorporated unpaid claims received to 31 March 2015 and an estimate of future claims. The timing of potential claims is dependent on the timing and volume of appeals lodged against the Council. There is a potential for an increase in claims after implementation of the revised Job Evaluation review, scheduled for 1 June 2016.	**Our approach has focussed on:** ► Review of claims received and settled in the financial year ► Challenge of the assumptions used by management when determining its estimate of future claims ► Review of any legal advice obtained by the Council with reference to the risks of litigation posed by the implementation of the Job Evaluation review.	The equal pay provision at 31 March 2016 has been reduced to £280k. This reduction has been made as the Council has received very few claims after its Job Evaluation Review was announced. However, on 1 June 2016, Derby City Council implemented its job-evaluation scheme. 29 August 2016 was the cut-off date for equal pay claims

Other Risks	Audit procedures performed	Assurance gained and issues arising
		and no further claims have been received. Many employees accepted their new terms of employment, but the Council needed to dismiss and re-engage a minority of employees. This led UNISON to ballot its school-based members. Discontinuous strike activity started in the city's schools on 16 June 2016. In September 2016 the Council made an offer to UNISON in an attempt to bring an end to the strikes. The offer included paying £2,000 to members of support staff who lost pay due to changes to their working hours or working weeks. But this only applied to those who worked in the schools environment. UNISON members rejected the offer. We will continue to monitor the progress of this issue up to the date on which the 2015/6 financial statements are finalised to enable us to form a view as to whether the provision is sufficient to cover the likely potential outflow as a result of this issue.
Backdated Non-Domestic Rates claims by NHS Trusts The sector is subject to an emerging issue with respect to NHS Trusts and Foundation Trusts lodging applications to their Local Authority to claim backdated relief on the Non-Domestic Rates paid. The Council is in receipt of such applications. The likelihood and value of any possible settlement is unknown, and due to the scale of the issue, is unlikely to be known for some considerable time as test cases are put before the Courts.	Our approach has focussed on: ► Review of claims received by the Council ► Review of any legal advice obtained by the Council ► Challenging Management's assessment of the likelihood of any claim being successful, and the resultant financial implication ► Review of the adequacy of disclosure within the financial statements.	The Council have signed up to a Local Government Association (LGA) initiative to fight these claims on a national level. The Council has not included within its draft financial statements a provision in respect of this claim, nor disclosed the matter as a contingent liability. We agree with this treatment.
Private Finance Initiative (PFI) Arrangements The Council has a number of assets held under PFI arrangements. Four of these are recorded on the Council's balance sheet, one is not. Such arrangements are complex and substantial in value.	Our approach has focussed on: ► Obtaining and documenting an understanding of the schemes ► Considering whether the scheme falls within IFRIC 12 and should be accounted for on balance sheet ► Using our PFI specialists to consider whether the accounting model reflects the operator's model and produces reliable results for the financial statements ► Ensuring the outputs from the accounting model are correctly reflected in the financial statements, and relevant disclosures have been made	The Council has 5 PFI schemes (4 are recorded on the balance sheet, 1 is not). We have reviewed the Council's rationale for the on/off balance sheet treatment and concur with the treatment adopted. We have used our PFI specialist to perform a review of each of the schemes to obtain assurance that the schemes have been accounted for appropriately and have not resulted in a material misstatement in the financial statements. Our work in this area is substantially complete and we expect to conclude that the PFI schemes are free from material misstatement. However, our work has illustrated the lack of corporate memory with respect to the schemes. The Council no longer has any staff member who understands the terms of the agreements nor the complex underlying models. This increases the risk that errors will be introduced into the accounting for these

Other Risks	Audit procedures performed	Assurance gained and issues arising
		schemes, or that the contract terms are not followed.

As our audit procedures have progressed, we have identified the following additional audit issues which we wish to bring to your attention.

Heritage Assets

The draft financial statements show Heritage Assets at 31 March 2016 of £75.5mn. The Council's accounting policy states that ' … all heritage assets are reported in the Balance Sheet at insurance valuation. These insurance valuations are reviewed by internal subject experts on an annual basis to reflect any changes for damage, authenticity or deterioration in condition.'

Observations

We requested evidence of expert review of the valuations assigned to the Council's heritage assets. We have been informed that the valuations for heritage assets included in the financial statements are in actual fact not reviewed by internal subject experts on an annual basis. In reality, the valuations have not been reviewed since the assets were first recorded on the balance sheet some seven years ago.

This is not in compliance with the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom which requires that 'where heritage assets are measured at valuation, the carrying amount shall be reviewed with sufficient frequency to ensure that the valuations remain current'.

The Council should instruct its internal subject experts to review the value of its heritage assets in line with the stated accounting policy, in order to confirm whether the valuations remain current. Until this work is undertaken we are unable to conclude whether the heritage assets are materially misstated.

Cash and Cash Equivalents

The draft financial statements show a cash and cash equivalents balance at 31 March 2016 of £67.6mn.

Observations

The Council's processes for the management and control of the cash and bank balances are weak. The following control observations have been noted and communicated to management.

Ownership of the cash management function

- There is no high-level review and challenge of balances in the cash accounts being performed. For example, a school has a cash balance at 31 March 2016 in excess of £1.6mn and is a clear outlier. The Council was unable to provide explanation for this large cash balance for over three weeks. The explanation given for the high balance is that the school also has a high creditor balance (unpaid suppliers of c. £800k). This still means that the school has £800k of cash and so in our view should have been on the Council's 'radar' from a cash management perspective.
- Difficulties encountered during the implementation of a new income management system in the year have resulted in Oracle bank reconciliations for all accounts not being performed on a timely basis. These reconciliations are also not retained centrally. This means that information is not readily available for review or audit.
- Bank reconciliations performed at the year-end do not consistently use the year-end bank statement.
- The Council's working papers to support bank reconciliations and cash transactions throughout the period under audit do not contain evidence of the closing bank balance. Online statements are used when preparing bank reconciliations, but these are only available for the Council to access for a period of 12 months. Therefore when we requested to see evidence of transactions and balances in the bank accounts over 12 months ago (but within the financial year under audit), the evidence was not available in the supporting working papers. A full 12 months of bank statements still in their envelopes were presented to audit when we requested evidence to support the 'balance per the bank' appearing in a reconciliation.
- The cash in hand accounts recorded in the 31 March 2016 financial statements were not reconciled at the year-end date, but instead at various earlier dates. The earliest date was 9 Dec 2013. Several were reconciled as at February 2016, or mid-March 2016.

Data cleansing:

- Cash and cash equivalent accounts in the general ledger are not clearly labelled such that the finance team are not readily able to determine which are petty cash accounts, and which are bank accounts.

- 82 accounts are included in the ledger with a zero balance at the end of the year however the Council is uncertain whether these are petty cash or bank balances and whether they are in fact still in use (8 of these accounts had zero movement in the year, and 76 accounts had 6.792mn in movements in the year, netting to zero).

The extent of control observations noted with respect to the management of cash balances is unacceptable. The Council has insufficient oversight of the cash management function and this should be addressed as a matter of priority.

Borrowings

The draft financial statements show short term borrowings at 31 March 2016 of £3.2mn, and long term borrowings at that date of £338.7mn

Observations

The short term borrowings in the draft financial statements only includes interest and not the capital repayment amount. The Council have taken out some annuity loans in 2015/16, which have principal repayments totalling £1,112k due in 2016/17. These should have been included in the short term borrowing total. We have included this on our schedule of unrecorded differences at Appendix A.

Tenants' Rents receivable and related provision

Tenants rents receivable are recorded in the draft financial statements at £4.2mn.

Observations

To date the Council have been unable to provide us with a schedule of the tenants making up the total balance outstanding at 31 March 2016. We are therefore unable to determine that the amount is either a) a valid receivable of the Council, or b) recoverable.

When we consider the fact that there is no historic record of tenants rent receivable at any point in time, and the weak controls over the cash management discussed above, there is a significantly increased risk of fraud. This is a risk which Management need to address as a matter of urgency.

Consolidation of Derby Homes Limited

As we communicated in our Audit Plan, we have performed procedures to direct, oversee and conclude upon the work performed by BDO LLP as auditor of Derby Homes Limited in support of the group audit opinion. This has included the issuing of group instructions to BDO LLP, the receipt of formal reporting to EY on conclusion of their planning work and final audit opinion, as well as direct verbal communication between EY and BDO LLP to discuss the extent of work performed on the balances of Derby Homes Limited which are consolidated in the Council's group accounts and any issues arising.

Observations

No significant issues have arisen as a result of the component auditor's audit procedures with respect to Derby Homes Limited, although some final reporting from BDO LLP remains outstanding at the time of writing.

Presentation and disclosure matters

The presentation and disclosure of items within the Councils financial statements is governed by statute, accounting standards, and the Code of Practice on Local Authority Accounting in the United Kingdom.

Observations
We have highlighted to management a number of presentation and disclosure corrections to be made to the draft financial statements in order to comply with accounting standards, and the Code of Practice on Local Authority Accounting in the United Kingdom. We will work with management to ensure that all the necessary changes are made in the final statement of accounts.

Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to you oversight of the Council's financial reporting process, including the following:

- Qualitative aspects of your accounting practices; estimates and disclosures;
- Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions;
- Any significant difficulties encountered during the audit; and
- Other audit matters of governance interest

We wish to report the following matters

- Several of the audit issues raised potentially call into question the balances reported in the Council's financial statements as at 31 March 2015. Our audit opinion for the year ended 31 March 2016 has to consider whether the opening position was free from material misstatement (and if it was not, then a prior period adjustment must be recorded). Concerns over the valuation of PPE, Heritage Assets, and the existence and recoverability of Tenant's rents receivable may also indicate that the opening position was materially misstated. Management need to perform sufficient procedures to satisfy themselves, and EY, that the opening position was not subject to the same concerns as the closing position.
- Annually the Head of Internal Audit is required to form an opinion on the adequacy and effectiveness of the Council's overall internal control environment. For the 2015/16 financial year the Head of Internal Audit's opinion is that 'there is an acceptable level of internal control within the Council's systems and procedures'. **We disagree with this view**, primarily for the following reasons:
  - The Council was unable to publish its draft statement of accounts for the year ended 31 March 2016 in line with the statutory deadline of 30 June 2016;
  - The Council has been the subject of a report in the public interest in the period and several matters discussed in the report are ongoing for at least part of 2015/16;
  - Significant and widespread control failings with respect to the management of the Councils fixed asset register (and associated valuations) have been identified as a result of the work that the Council's Estates team has been performing over the latter part of the 2015/16 financial period (as set out in this progress report);
  - The widespread instances of control weaknesses we have noted throughout our audit procedures, as documented in this progress report; and

- ► The significant issues that have been identified with respect to the Council's arrangements for securing value for money (as set out in section 4 of this progress report) and which lead to an adverse conclusion being drawn.

- ► Our IT specialists have performed some limited procedures to assess the controls in place around access to the Capita system and change management to the system itself. This work identified a number of control weaknesses which has meant that we are unable to place any reliance on these systems when performing our audit procedures. Full details of the control weaknesses found are included in Appendix B. We note that several of these weaknesses were also reported to the Committee by our predecessor in their 31 March 2015 Audit Findings report. No progress appears to have been made to address the issues found.

- ► We have experienced significant delays in obtaining some supporting evidence for our testing. We believe that this has been caused, at least in part, by decentralisation of record keeping and the lack of individual accountability for the overall balances reported at the year end date.

- ► A full set of reviewed working papers were not provided to us alongside the draft financial statements.

- ► There is significant scope to improve the quality of working papers prepared by the Council in support of the draft financial statements.

Control themes and observations

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As we noted in our Audit Plan, our intention was to test the internal controls in place at the Council and place reliance upon them. However, our initial procedures to document and understand the processes and controls in place at the Council highlighted some control weaknesses which we felt it appropriate to communicate to the Audit Committee at that time – and these were included in our Audit Plan.

We have therefore adopted a fully substantive approach and have not tested the operation of controls. However, as our audit work has progressed we have identified a number of observations and improvement recommendations in relation to management's financial processes and controls.

The matters reported below are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported to you.

Description	Impact	Management response
Difference between the general ledger and the trial balance The trial balance is a report which summarises the closing balances of all accounts in the general ledger. We have noted a difference between the general ledger and the trial balance for the 'Surplus/Deficit on the provision of services'. The value on the trial balance shows £32,146,000 however the value in the general ledger shows £31,268,000. We have traced all individual items which make up the total 'Surplus/Deficit on the provision of services' on the trial balance to the general ledger and not found any exceptions. In addition, we have reviewed the general ledger for items not appearing on the trial balance, and again have not found any exceptions. We therefore believe that this issue is likely to have been caused by an addition error within the general ledger in Oracle. This is a significant concern and has a potential impact across the entire financial statements.	There is no obvious reason why the trial balance should show a balance which does not agree to the general ledger (since the trial balance is a report from the general ledger). The presence of this imbalance calls into question the robustness of the accounting system and the information therein. Management should investigate and resolve this issue as a matter of priority.	The discrepancy identified was limited to one high level system 'parent code' value and has since been identified and a solution created in the systems test environment. The Business Systems section are working to rectify the issue which should take place on 24/25 September when Oracle live can be taken off line to be updated. All lower level 'parent code' values and detailed transactions are consistent. As the council uses the OBI reporting tool for monitoring/forecasting and reporting it is unlikely that this imbalance could have resulted in a material issue.
Reconciliation between Council Tax and NNDR System and the General Ledger No reconciliations have been performed between the Council Tax/NNDR system and the general ledger throughout the year. The reports from the Council Tax/NNDR system feed directly into workings which form part of the ledger entries. We have performed these reconciliations as at 31 March 2016 and identified a difference of £56,337.57 between the Council Tax system and the general ledger.	Failure to reconcile the general ledger to feeder systems increases the risk that errors or omissions in the financial statements go undetected and uncorrected. Whilst the difference noted by EY when we reconciled the Council Tax feeder system to the general ledger is small, the nature of controls account reconciliations is that this could represent a small net difference, masking large upward and downward movements.	The NNDR and CTAX Academy system does not interface with the GL and so entries/balances are replicated in the GL at year end based upon system reports. In addition the Academy system updates overnight and so can be out of date as the balance will not reflect income received on the 31 March of each financial year. The cash balance does show this income as received in the correct year and so NDR/CTAX balances are adjusted within the ledger to reflect this. The differences noted do not arise from the GL not being reconciled to Academy but rather the adjustments made for timing differences could not retrospectively be evidenced. We will provide a specific reconciliation for this issue as part of the 2016/17 closure process.
Reconciliation between Tenants Rental Income Ledger and the General Ledger A reconciliation was performed between these two systems at 31 March 2015. There was an unexplained reconciling difference of £254k at that date. At 31 March 2016 there is an unexplained reconciling difference of £449k.	Failure to investigate significant reconciling differences between the general ledger and feeder systems increases the risk that errors or omissions in the financial statements go undetected and uncorrected. Furthermore, when taken together: ► a large reconciling difference between the tenants rental income system and the general ledger, ► the inability to provide a breakdown of individual	We recognise that there is a historic unexplained difference between the two systems. This is being investigated further. We are able to provide a breakdown of individual invoices making up the outstanding tenants rents but not completely as at 31 March 2016. The rents system is a live system and it is not possible to run a report that can recreate the position retrospectively. We have reconciled

Description	Impact	Management response
	invoices making up the outstanding tenant's rents receivable at the year end, and ► weaknesses in the management of cash balances creates an opportunity for fraud to be perpetrated with respect to these balances.	the summary of the rent account balances for two of the four elements but the detail is only available for the rent and rechargeable repairs accounts but not the court costs and missed appointments. Additionally we have reconciled the opening debtors using the report which details the debits generated, income received with the year-end balance. We have also reconciled an EY provided sample of 4 rent accounts and rolled these back to 31 March 2016 and are able to prove the balances but this is impractical for all 13,000 properties. We have established that an image of the Academy system is taken at year end so we have requested a copy of this with a view of trying to run the appropriate reports on this image. This has been a difficult issue to evidence for EY, so specific plans to address this for 2016/17 will be reviewed. Although a reconciliation is undertaken monthly there are unresolved balances that require investigating further. However, there are separate reconciliations undertaken by the income team to identify and allocate cash receipts. We will continue to develop processes to tighten up on this issue.
Lack of resource leading to breakdown in the control environment We have observed several instances of control failure and poor practice with respect to record keeping which appears to have been caused by a lack of appropriately experienced resource. Examples include: ► Failure to determine NNDR write-offs (In 2014/15 NNDR Debt Write Offs were £1.4mn. For 2015/16 write-offs have been £200k). We have been told that this is due to a shortage of staff able to perform this exercise. This has resulted in the NNDR Debtors increasing year on year by 149%.	Failure to keep on top of the maintenance of proper accounting records increases the risk that material misstatements will arise.	The Council had a change of senior management structure in September 2015 which led to a review of the scheme of delegation for write-offs. This has now been set. We are also in the process of reviewing the historic debt position for consideration during 2016/17. Whilst we acknowledge the finding, we do not accept that the situation has led to a 'breakdown in the control environment'.
Role transition without appropriate handover We have noted several instances where resource changes in the year have occurred, but the required amount of handover has not been performed. This has led to individuals being unclear as to the requirements of the role, and despite their best efforts, being unable to respond to audit enquiries. Examples include:	Corporate memory is eroded over time as staff members move on and their knowledge is not transferred to others in the organisation.	Knowledge within PFI schemes has been impacted following successive officers leaving the authority in the past 12 months. Transfer of knowledge has therefore been problematic. A change of organisational structure in September 2015 has given rise to a number of changes in duties across the finance function, where knowledge will take time to develop. In more general terms we accept the need to develop a greater understanding of the audit

Description	Impact	Management response
► PFI schemes, as noted above. ► Accountancy team for Adult, Health and Housing. ► Accountancy for Communities and Places.		requirements of our new auditors. We aim to achieve this collectively through post audit review and training sessions.
Lack of accountability of individual service teams We have noted examples of service teams providing information to the corporate accounting team for inclusion in the year-end financial statements which is delivered either late, without proper review, or both. For example, the schedule of accumulated absences provided to the Corporate accounting team by HR was so inaccurate that they were unable to use the data and instead resorted to re-using the prior year data as an approximation to current year.	This undermines the quality of financial reporting at the Council.	We accept that there is a wider training need for service departments to understand their requirements to support the accounts process. We will undertake a training exercise prior to the 2016/17 audit.

Narrative Statement and Annual Governance Statement

We have reviewed the draft Narrative Statement and provided a number of amendments to management. These amendments have now been made.

The Narrative Statement will now need to be amended once more to reflect on the causes of the delayed issuance of the final financial statements.

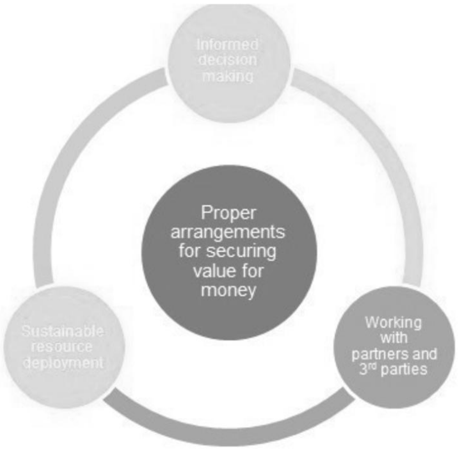
At the time of writing we have not received a sufficiently final version of the Annual Governance Statement upon which to commence our review.

Whole of Government Accounts

Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the National Audit Office.

We are unable to commence this work until the Council has prepared a revised statement of accounts addressing the matters raised in this report.

4. 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. This is known as our value for money conclusion.

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.

Significant risks

As reported to you in our Audit Plan, we identified two significant risks in relation to these arrangements:

- **Proper arrangements for sustainable resource deployment**

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

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

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

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

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

- **Proper arrangements for informed decision making**

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

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

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

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

Subsequent to the issuance of our Audit Plan and as we have followed the progress of the development of a corporate risk strategy and strategic risk register, we have noted the slow progress made. We consider this to be an additional significant risk to the arrangements.

Overall conclusion

We have performed the procedures outlined in our audit plan.

We identified the following significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Area of focus:	
Informed decision making	The absence of a MFTP for the majority of the year leads us to conclude that the Council does not have proper arrangements in place to ensure informed decision making. There was no corporate risk strategy in place that covered 2015/16. The draft strategic risk register went to Chief Officer Group in November 2015as a working copy for them to comment on. It was agreed that a clearer definition of the risk appetite was needed. Furthermore, the public interest report issued by Grant Thornton in June 2016 made several recommendations with respect to issues continuing in the 2015/16 financial year which are relevant to the Council's arrangements for ensuring informed decision making, including: ► Review of project procurement and monitoring systems to ensure that appropriate decisions are made regarding externally commissioned services ► Ensure continued monitoring of Member interventions in operational matters relating to taxi licencing ► Review the quality of decision making by the taxi licencing committee ► Reinforce the need for officers to observe the Council's contract procedure rules. In addition, in year the Council received a whistle-blowing allegation with respect to the valuation processes and practices being used by the in-house Estates team. This has led to a significant exercise being undertaken by the Council to review and reperform asset valuations. Two members of staff have had their employment with the Council terminated. EY have involved our valuations experts. Our testing has revealed numerous issues with respect to the completeness of the asset register, the existence of assets on the register, the valuation techniques/assumptions being used, and the data management with respect to the fixed asset register entries and the valuations determined by the valuers. This has led us to conclude that the Council does not have proper arrangements in place in order to make informed decisions with respect to PPE. Maintaining a sound system of internal control Whilst performing our audit procedures we found that some of the basic financial controls were not working as expected. For example, the regular completion and review of reconciliations was not timely (or in some cases not performed at all). This increases the risk of fraud or errors remaining undetected. We specifically note the risk of fraud referred to above which arises as a result of the Council not having historic records which show at month/year end a detailed breakdown of Tenant's rents owed by property/individual and the weak control environment noted around the management of cash which presents an opportunity for fraud with respect to rental income from Council tenants.
Sustainable resource deployment	Since the Council have not had a MTFP in place throughout the entire period under audit, this demonstrates that they have not planned finances effectively over the entire year under review in order to effectively support the sustainable delivery of strategic priorities and maintain statutory functions.
Working with partners and other third parties	We have not identified any significant concerns with respect to the Council's arrangements for working with partners and other third parties.

We therefore expect to conclude that you have not put in place proper arrangements to secure value for money in your use of resources.

The draft proposed wording for our value for money conclusion is included at Appendix C.

Other matters to bring to your attention

We noted the following issues as part of our audit.

Insurance
Insurance over the Council's assets Concerns have been raised throughout the 2015/16 financial year as to the level of insurance cover over the Council's assets. In July 2016 a recommendation was taken to Cabinet that external temporary quantity surveyors be engaged to carry out a program of insurance valuations on Council properties. Appropriate levels of insurance in respect of the Councils assets is a relevant factor when considering whether proper arrangements are in place to secure sustainable resource deployment. We therefore encourage the Council to ensure that a process is put in place such that when the aforementioned program of insurance valuations comes to a conclusion, those valuations can be appropriately maintained going forward.

Appendix A Uncorrected audit differences

The following differences, which are greater than £346k, have been identified during the course of our audit. We are bringing them to the Committee's attention to enable you for form your own view on these items.

Balance sheet and Statement of comprehensive income and expenditure

Item of account	Balance sheet (Decrease)/Increase £'000	Comprehensive income and expenditure statement (Decrease)/Increase £'000
Valuation of Council Dwellings	(2,000)	
Revaluation reserve	2,000	
To adjust the valuation of Council Dwellings following validation by the Council's Estates team.		
Opening Property, Plant & Equipment	(37,000)	
Opening Reserves	37,000`	
To recognise the impairment of Assembly Rooms valuation recorded in the wrong year		
Opening Property, Plant & Equipment	3,000	
Opening Reserves	(3,000)	
To recognise the Assembly rooms carpark valuation		
Opening Property, Plant & Equipment	(5,600)	
Opening Reserves	5,600`	
To remove 'parks and open spaces' which cannot be identified		
Property, Plant and Equipment	10,000	
Depreciation expense		10,000
To remove excess depreciation charged by incorrectly assuming a useful economic life of one year for in-year additions to 'other land and buildings'		
Opening Property, Plant & Equipment	(4,700)	
Opening Reserves	4,700	
To account for the derecognition of assets recorded in the wrong period		
Property, Plant & Equipment	(1,200)	
Depreciation expense		(1,200)
To account for depreciation on play equipment	(1,200)	(1,200)
NNDR appeals provision	(2,700)	
Taxation and non-specific grant income		(2,700)
Being understatement of NNDR appeals provision	(2,700)	(2,700)
NNDR doubtful debt provision	(672)	
Taxation and non-specific grant income		(672)
Being understatement of NNDR doubtful debt provision	(672)	(672)
Council tax doubtful debt provision	(3,600)	
Taxation and non-specific grant income		(3,600)
Being understatement of Council Tax doubtful debt provision	(3,600)	(3,600)
Short term borrowings	1,112	
Long term borrowings	(1,112)	
Being reclassification of long term and short term borrowings		
Cumulative effect of unadjusted differences	**1,828**	**1,828**

Appendix B IT Controls report

1. Background and Scope

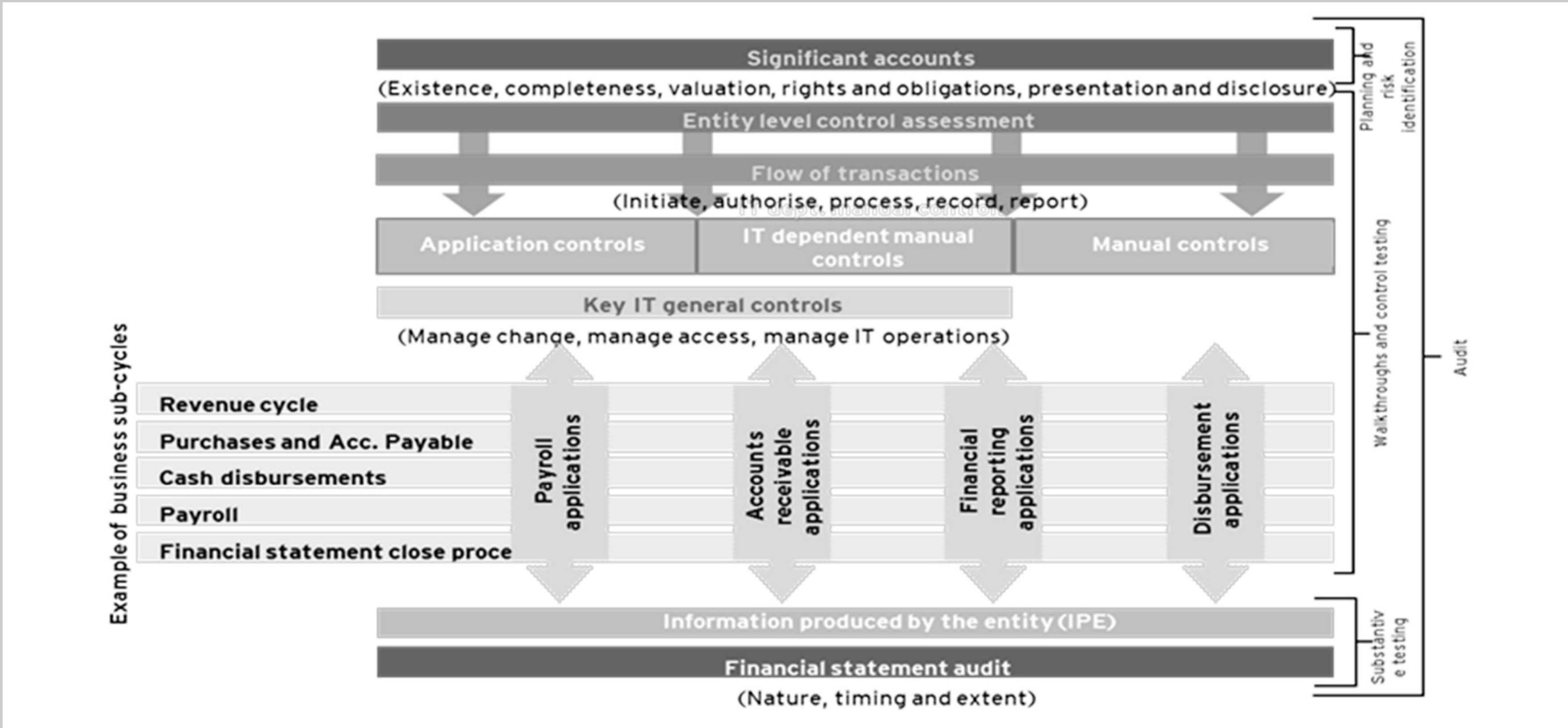
As part of our external audit of Derby City Council, we seek to place reliance on internal controls supporting the financial reporting processes within individual business divisions. IT general controls (ITGCs) over information systems are a key part of this control framework.

Information Technology General Controls (‘ITGCs’) will often contribute indirectly to the achievement of many or all of the financial statement assertions. This is because effective ITGCs help to ensure the continued and effective operation of application controls and automated accounting procedures that depend on computer processes. ITGCs are also important when manual controls depend on application-generated information.

We had an initial meeting with Derby City Council to get an early understanding of the control environment. Based on these initial planning discussions, we agreed that the scope of the IT review will be restricted to performing a walkthrough of the IT controls and assessing the design of those controls. We, as such, have not performed any detailed testing over the key controls to evaluate their operating effectiveness across the audit period.

Our scope for the IT Walkthrough included the following system:

			Business Process					
Key Application	Database	Operating System	Payroll	Revenue	Cash	Purchase to Pay	Financial Statement Close Process	Fixed Assets
Capita Academy	Ingres	Solaris 10		ü	ü	ü		


Significant accounts
(Existence, completeness, valuation, rights and obligations, presentation and disclosure)
Entity level control assessment
Flow of transactions
(Initiate, authorise, process, record, report)
Application controls
IT dependent manual controls
Manual controls
Key IT general controls
(Manage change, manage access, manage IT operations)
Example of business sub-cycles
Revenue cycle
Purchases and Acc. Payable
Cash disbursements
Payroll
Financial statement close proce
Payroll applications
Accounts receivable applications
Financial reporting applications
Disbursement applications
Information produced by the entity (IPE)
Financial statement audit
(Nature, timing and extent)
Planning and risk identification
Walkthroughs and control testing
Substantive testing
Audit

2. Summary of Recommendations

Our key recommendations are summarised below indicating a priority for their resolution. The items are broadly classified as being high, medium or low priority.

High	Significant weaknesses that could undermine the effectiveness of the system of internal controls or have a significant impact on business operations and should therefore be addressed immediately
Medium	Weaknesses that could reduce the effectiveness of the system of internal controls or could disrupt business operations, but which are not fundamental. They should be addressed as soon as possible.
Low	Improvements that represent best practice or opportunities to enhance efficiency or control. The finding will not necessarily imply inadequate control

		Risk		
#	**Recommendation**	**H**	**M**	**L**
1	Administrator rights granted to business users should be revoked	ü		
2	System supplier has continuous access to production hence access should be monitored for changes		ü	
3	Periodic user access review and sign off evidence should be retained		ü	
4	Weak password parameters to be addressed			ü
5	New user process does not define access requirements			ü

3. Detailed Observations

3.1 Administrator rights are granted to business users

Observation	Risk	Risk Rating	Recommendation
End users on the application are assigned security permissions to perform functions on the application. The security permission is assigned specific application programs to perform certain tasks. The application program 'sy3010' is required by the system administrator to create and modify user accounts on the application. This program is assigned to security permissions 'SY Batch Scheduler' and 'SY Password reset'. These permissions have been assigned to 44 users. We understand business users were previously responsible for resetting their own passwords if the user account was locked hence this access. In addition business users would also be responsible for setting up adhoc schedule jobs to perform transactions on the system.	If segregation of duties is not established between business and IT functions, there is an increased risk of a user deliberately or accidentally creating or amending user accounts to have system access greater than required for that user's role and responsibilities.		We recommend that management restrict those who have privileged access to the system, and periodically review it to ensure that those with this enhanced level of access remain appropriate.

Management Comments

Addressed – Admin permissions for password resets have already been removed.

3.2 System supplier has access to develop and deploy changes

Observation	Risk	Risk Rating	Recommendation
The system supplier has continued remote access to the production environment which allows them to develop and implement changes on the application both functional and data changes. There is no periodic monitoring performed to ensure the suppliers access is valid each time they access the production environment.	A lack of segregation of duties within the change management process without an effective monitoring control could result in unauthorised changes being released into production that go unnoticed by management. These changes could impact the functionality of the system and/or the integrity of data used by management for financial statement reporting purposes.		We recommend that management work with the vendors to determine whether access to develop and implement changes can be segregated. Alternatively we recommend that management implement a control to periodically monitor changes that have been implemented to confirm the validity of these changes.

Management Comments

Addressed – New monthly script put in place to list all updates by supplier login. This will be reviewed on a periodic basis.

3.3 Periodic user access review not retained

Observation	Risk	Risk Rating	Recommendation
A bi-annual review is performed by management to assess whether permissions granted to users are appropriate. However, we identified the following: 1. No evidence of management sign-off is retained to confirm the review had taken place. 2. Privileged access is not included in the review. 3. The review is performed by management (Head of Service) who also has access to administer accounts on the application.	The absence of controls to periodically review and monitor the appropriateness of end user and particularly privileged user access increases the risk that this access does not remain commensurate with the user's job role. This could lead to unauthorised access and changes being made to financially significant applications, which may compromise the integrity or confidentiality of data used for financial reporting and management's decision making purposes.		Management should consider retaining evidence of the bi-annual review of user accounts and also review privileged access privileges to validate that access continues to remain appropriate and in line with the user's job responsibilities. The review should also be performed by an individual without administration access on the application.

Management Comments

A mechanism for formal business sign off will be implemented.

3.4 Weak password parameters

Observation	Risk	Risk Rating	Recommendation
Single sign on (SSO) authentication is in use; as such we identified the following findings on the network: 1. Account lockout attempts are set to 10. 2. Account lockout duration is set to 15 minutes.	Inadequate password settings can result in password security being compromised and therefore increasing the risk of unauthorised access to financially significant data.		Management should consider implementing the generally accepted password settings as below: 1. Account lockout attempts: 3 to 5 attempts 2. Account lockout duration: zero (reset required)

Management Comments

DCC have applied the guidance contained in Password guidance: simplifying your approach published on 8 September 2015.

https://www.gov.uk/government/publications/password-policy-simplifying-your-approach/password-policy-executive-summary

3.5 New user process does not define access requirements

Observation	Risk	Risk Rating	Recommendation
The access required on the application for a new joiner is not explicitly documented in the access template or the service ticket.	There is a risk that unnecessary and/or inappropriate user access rights will be granted to the system user which can be used to compromise the integrity and confidentiality of the financially significant data.		We recommend management encourage the clear documentation of access requirements for new users.

Management Comments

New user permissions are essentially role based rather than detailing every specific permission. Nonetheless, requests received are inconsistent in the information they provide and working practices blur role based access. The regular review in (3.3) is the opportunity to identify any incorrect permissions.

Appendix C Draft Value for Money Conclusion

Basis for Adverse Conclusion

- Medium Term Financial Planning and strategic risk management

  At the start of the financial year ended 31 March 2016, Derby City Council did not have a sustainable Medium Term Financial Plan (MTFP). Following the Autumn 2015 spending review, the Council revisited the MTFP and were able to construct a balanced 3 year budget. This budget was approved by full Council in February 2016.

  The absence of a sustainable MTFP for the majority of the year ended 31 March 2016 together with the continued absence of a corporate risk strategy and risk register is evidence of weaknesses in proper arrangements for informed decision making and planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.

- Completeness, Existence and Valuation of Property, Plant and Equipment (PPE).

  The Council received a whistleblowing allegation with respect to its valuation processes in the year which has led to a significant exercise being undertaken to review the Council's entire PPE portfolio to assess its completeness, existence and valuation. This work is ongoing and to date the Council has been unable to provide sufficient appropriate evidence to support the completeness, existence and valuation of the property, plant and equipment held in the balance sheet at 31 March 2016. This provides evidence of weaknesses in proper arrangements for informed decision making.

- Governance issues and management of major projects

  Derby City Council was the subject of a public interest report issued by Grant Thornton in June 2016 in relation to identified failures of governance at Derby City Council in the management of major projects and in relation to Member conduct.

  The recommendations made in the public interest report are evidence of weaknesses in proper arrangements for informed decision making.

- Maintaining a sound system of internal control

  We found that some of the basic financial controls were not working as expected, for example, the regular completion and review of reconciliations was not timely. This increases the risk of fraud or errors remaining undetected and provides evidence of weaknesses in proper arrangements for informed decision making.

Adverse conclusion

On the basis of our work, having regard to the guidance issued by the C&AG in November 2015, we are not satisfied that, in all significant respects, Derby City Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2016.

Appendix D Outstanding matters

The following lists the most significant matters relating to the completion of our audit procedures that are outstanding at the date of the release of this report

Item	Actions to resolve	Responsibility
Property, plant and equipment (PPE) and Heritage Assets	Management to perform a thorough review of asset valuations to satisfy themselves that the PPE valuations are free from material misstatement. Management to perform a data matching exercise between total values attributed to assets on the fixed asset register, and values attributed to assets by the Estates team. EY to perform further subsequent testing of an additional sample of assets by EY valuations expert. EY to test the data matching exercise to ensure assets on the fixed asset register match to the Estates valuations. Once revised asset valuations are agreed, depreciation will need to be recalculated and audited, as will all related accounts in the primary statements and notes to the financial statements.	Management EY EY and management
Substantive testing of Fees, Charges and Other Service Income	Evidence to be supplied to EY to demonstrate for each of the transactions selected, that the revenue a) was earned by the Council and relates to the 2015/16 financial year, and b) is appropriately classified.	EY and management
Substantive testing of Expenditure	Evidence to be supplied to EY to demonstrate for each of the transactions selected, that the expenditure has been incurred by the Council in relation to the 2015/16 financial year and recorded correctly.	EY and management
Capital Grants	Evidence to be supplied to EY to support capital grant receipt/utilisation/recognition in the year.	EY and management
Tenants rents receivable	Evidence to be supplied to EY to demonstrate that the amounts were owing to the Council at 31 March 2016 and are recoverable.	EY and management
Pension scheme assets and liabilities	Completion of audit procedures with respect to actuarial valuations.	EY
Whole of Government accounts	Completion of procedures required by the National Audit Office (NAO) regarding the Whole of Government Accounts submission. This work cannot be commenced until a final set of accounts subject to audit is presented to us	Management and EY.
Management representation letter	Receipt of signed letter of representation	EY, management and Audit Committee
Final version of financial statements including narrative statement	► Incorporation of EY review comments on disclosure notes ► Posting of adjustments ► Approval of accounts by Audit Committee ► Accounts re-certified by s151 Officer	EY, management and Audit Committee
Subsequent events review	Completion of the subsequent events procedures to the date of signing the audit report	EY and management

Appendix E Independence

We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan dated 23 March 2016.

We complied with the Auditing Practices Board’s Ethical Standards for Auditors and the requirements of the Public Sector Audit Appointments Ltd (PSAA)’s Terms of Appointment. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We confirm that we are not aware of any relationships that may affect the independence and objectivity of the firm that we are required by auditing and ethical standards to report to you.

We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Audit Committee on 23 March 2016.

We confirm that we have met the reporting requirements to the Audit Committee, as ‘those charged with governance’ under International Standards on Auditing (UK and Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements was set out in our Audit Plan of 23 March 2016.

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Ernst & Young LLP

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com