

Darlington Borough Council

Year ending 31 March 2016

Audit Planning Report

Presented to the Audit Committee 18 March 2016

Ernst & Young LLP





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18 March 2016

Dear Sirs

Audit Planning Report

We are pleased to attach our Audit Planning Report which sets out how we intend to carry out our responsibilities as your external auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2015/16 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments Ltd ("PSAA"), auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Audit Committee's service expectations.

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

We welcome the opportunity to discuss this Audit Planning Report with you on 18 March 2016 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Nicola Wright
Executive Director
For and behalf of Ernst & Young LLP
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In April 2015, Public Sector Audit Appointments Ltd (“PSAA”) issued the “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 Planning Report is prepared in the context of the Statement of responsibilities. It is addressed to the Audit 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. Executive Summary

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

- ▶ Our audit opinion on whether the financial statements of the Council give a true and fair view of the financial position as at 31 March 2016 and of the income and expenditure for the year then ended;
- ▶ Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness; and
- ▶ Our review of the Whole of Government Accounts return, which we are required to report to the National Audit Office ("NAO"), to the extent and in the form required by them.

We will also 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.

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 add value to the Council.

The following 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 section 2 of this report.

Significant risks - financial statements (Section 2.2)

- ▶ Risk of fraud in revenue recognition
- ▶ Risk of fraud in expenditure recognition
- ▶ Valuation of land and buildings
- ▶ Risk of management override of controls

Significant risks - Value for Money (Section 2.3)

- ▶ Financial planning
- ▶ Children's services Ofsted inspection

Our approach to the audit will continue to evolve as our audit procedures are completed and we will provide updates to the Committee on any changes to our Plan in June 2016.

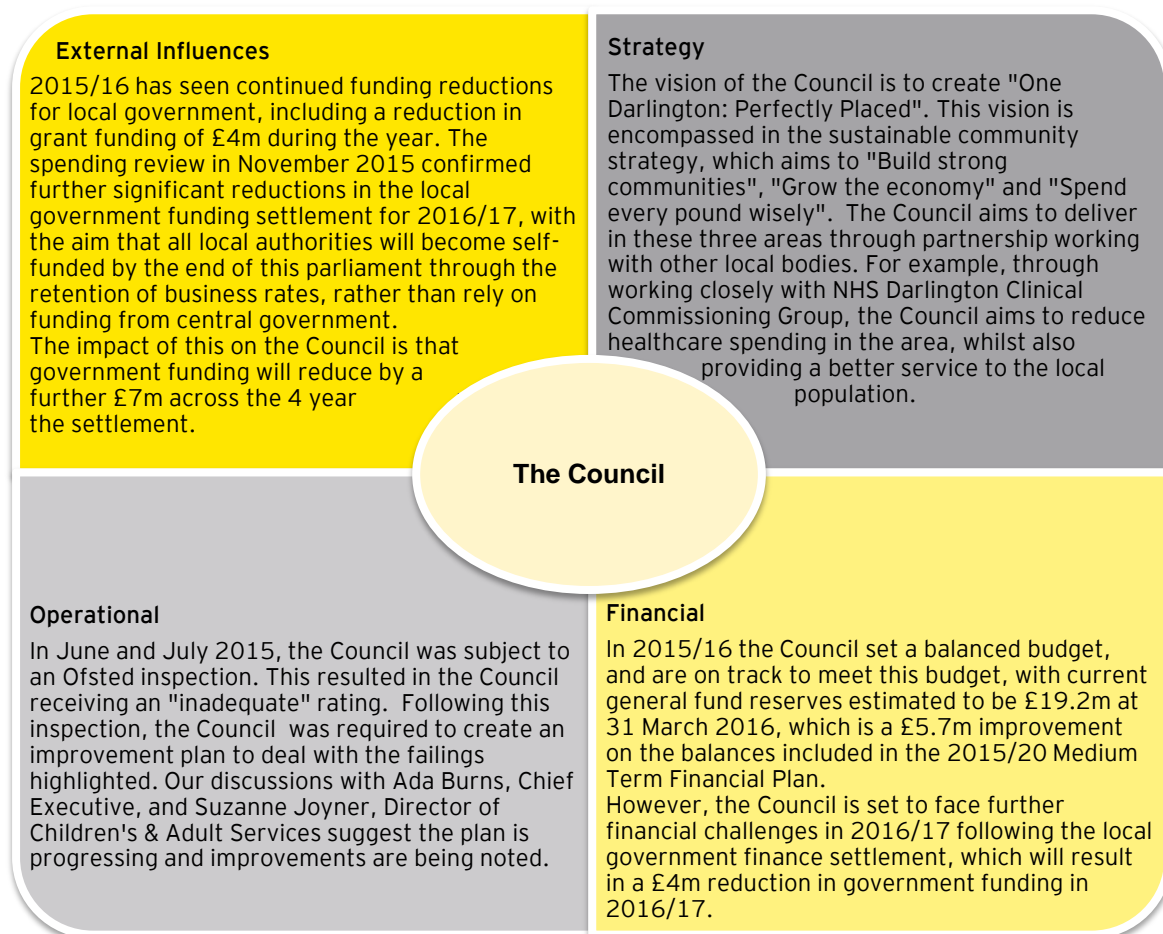
We will provide an update to the Audit Committee on the results of our work in these areas in our report to those charged with governance scheduled for delivery in September 2016.

2. Risk based approach



2.1 Risk Analysis

We analyse the risks inherent in your external environment, the key strategic, operational and financial risks for the Council and our knowledge of other factors that may impact the Council's financial statements. The output of this analysis is then mapped to the financial statements and this risk assessment process informs where we will focus our audit work for the year ending 31 March 2016.



Auditing standards require us to firstly identify the relevant financial statement risks and then consider whether any of the risks identified are 'significant' risks to our audit of the Council. Significant risks are defined as those with a higher likelihood of occurrence and, if they were to occur, could result in a material misstatement of the financial statements. We are required to identify significant risks to the audit, and perform specific procedures over those risks, including identification and testing of the design and implementation of key controls designed to address the risks.

2.2 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.

Significant risks (including fraud risks)	Our audit approach
<p>Risk of fraud in revenue recognition</p> <p>Under ISA (UK and Ireland) 240 there is a presumed risk that revenue may be misstated due to improper recognition. However, it is our assessment that this significant risk is only applicable to grant income that includes conditions, which require management to exercise their judgement when deciding upon when the revenue should be recognised.</p>	<p>We will:</p> <ul style="list-style-type: none"> ▶ Review grant correspondence attached to specific grants and compare to the Council's accounting treatment; ▶ Test grant income to ensure that recognition of income reflects grant conditions; and ▶ Review the completeness of grants recognised by comparing the available grants to the Council to those which have been recognised.
<p>Risk of fraud in expenditure recognition</p> <p>As noted above, under ISA (UK and Ireland) 240 there is a presumed risk that revenue may be misstated due to improper recognition. However, 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. In future years, the Council will experience increased financial pressures as funding for local authorities is squeezed further. Budget holders may therefore feel under pressure to try and bring costs into 2015/16, or to miscode expenditure to make use of resources intended for different purposes.</p>	<p>We will:</p> <ul style="list-style-type: none"> ▶ Review and test expenditure recognition policies; ▶ Review and discuss with management any accounting estimates on expenditure recognition for evidence of bias; ▶ Develop a testing strategy to test material expenditure streams, including testing revenue and capital expenditure to ensure it has been correctly classified; and ▶ Review and test the completeness of expenditure around 31 March 2016.
<p>Valuation of land and buildings</p> <p>Land and buildings is the most significant balance in the Council's Balance Sheet. The valuation of land and buildings is subject to a number of assumptions and judgements. A small movement in these assumptions could have a material impact on the financial statements.</p>	<p>We will:</p> <ul style="list-style-type: none"> ▶ Review the output of the Council's valuer; ▶ Challenge the assumptions used by the Council's valuer by reference to external evidence and our EY valuation specialists; and ▶ Test the journals for the valuation adjustments to confirm that they have been accurately processed in the financial statements.
<p>Risk of management override of controls</p> <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>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.

2.2 Financial statement risks (continued)

In addition to the significant risk areas highlighted above, our audit work will also consider the following risks which, although not likely to result in a material misstatement of the financial statements, require audit attention.

Other financial statement risks	Our audit approach
Opening balances <p>2015/16 will be the first year that we have completed your audit, and as such the requirements of ISA (UK & Ireland 510) apply.</p> <p>The basic objectives of an initial audit are similar to those of any audit engagement. However, when performing an initial audit, we report on the current period's assets, liabilities, and reserves, which are dependent upon the appropriateness of the opening balances.</p> <p>Therefore, we are required to perform additional procedures in order to gain assurance that the opening balances are free from material misstatement. These procedures cover all balance sheet items, including for example key judgement areas and Private Finance Initiative (PFI) assets and liabilities.</p>	<p>We will:</p> <ul style="list-style-type: none">▶ Review the work of the predecessor auditor, to identify any issues identified that may impact upon the opening balances;▶ Review the work of the predecessor auditor to ensure the audit has been completed to an appropriate standard to allow us to place reliance on their audit opinion;▶ Substantively test all opening balances to ensure that they agree both to the prior year audited accounts and closing trial balance; and▶ Review key judgement areas and PFI models to ensure that prior year disclosures in relation to PFI assets and liabilities are materially correct.
Accounting for pension obligations <p>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.</p> <p>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.</p>	<p>We will:</p> <ul style="list-style-type: none">▶ Review the output of the report from the Council's actuary;▶ Review the assumptions used by the actuary to determine whether they are in our expected range;▶ Test the journal entries for the pensions transactions to ensure that they have been accurately processed in the financial statements; and▶ Use EY Pension specialists to challenge the pension assumptions.

2.3 Value for Money risks

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. For 2015/16, 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.

2.3 Value for Money risks (continued)

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 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 risk which we view as relevant to our value for money conclusion.

Significant value for money risks	Our audit approach
<p>Financial planning</p> <p>Since 2010, the Council has faced government spending reductions amounting to £23m in cash terms. Following the local government finance settlement in November 2015, the Council is to face further reductions in government spending of £4m in 2016/17, with total reductions of £7m across the 4 year period of the settlement.</p> <p>There is therefore a risk that the Council finds it difficult to identify future savings and reductions, and as a result proper arrangements are not made to deliver value for money.</p>	<p>We will:</p> <ul style="list-style-type: none"> ▶ Select a sample of cost reduction plans and assess their reasonableness, including testing of the assumptions used; ▶ Maintain a watching brief over the cost reduction plans to ensure they are on target; and ▶ Review the medium term financial plan and test the reasonableness of the assumptions used.
<p>Children’s Services Ofsted inspection</p> <p>The Council was subject to an Ofsted review in June and July 2015. This resulted in the Council being provided with an overall “inadequate” rating.</p> <p>Since receiving this rating the Council has been working with external consultants, Red Quadrant, to develop an improvement plan and implement changes in relation to the actions raised.</p> <p>The Council will be re-inspected by Ofsted, however the exact timing of this re-inspection is not known.</p>	<p>We will:</p> <ul style="list-style-type: none"> ▶ Meet with Suzanne Joyner, Director of Children’s & Adult Services to discuss progress with the improvement plan; ▶ Review the improvement plan in order to ensure it addresses all failings highlighted as part of the Ofsted inspection; and ▶ Review progress against the improvement plan including detailed review and challenge of supporting documentation to ensure that proper arrangements have been put in place.

2.4 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; and
- ▶ Determining an appropriate strategy to address any identified risks of fraud.

3. Audit scope and execution



3.1 Audit Scope

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

Service deliverables	
Financial statement audit	<ul style="list-style-type: none"> ▶ 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 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
Arrangements for securing economy, efficiency and effectiveness (value for money)	<ul style="list-style-type: none"> ▶ We are required to consider whether the Council has put in place ‘proper arrangements’ to secure economy, efficiency and effectiveness in its use of resources

As well as work in relation to the financial statement risks and value for money risks, 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	<ul style="list-style-type: none"> ▶ 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
Required by the Code	<ul style="list-style-type: none"> ▶ Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement ▶ Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

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

3.2 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 preliminary materiality for the Council's financial statements is £5,100,000 based on 2% of gross expenditure as at the year ended 31 March 2015. We will communicate uncorrected audit misstatements greater than £255,000 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.

3.3 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 Committee for the 2015/16 financial statements. These dates are determined to ensure our alignment with PSAA's rolling calendar of deadlines.

We will provide a formal Audit Results Report to the Audit Committee in September 2016 for the Council's financial statements. This report will incorporate the outputs from our process and controls procedures and our year end audit procedures. From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Audit Committee Chair, as appropriate.

We will also provide you with real-time control issues and observations as identified where these are significant in nature. Our reporting to the Audit Committee will also contain practical business insights, updates on corporate governance and regulatory matters.

Following the conclusion of our audit we will also 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	Deliverables
Risk assessment and setting of scopes	January 2016	Audit Planning Report
Testing routine processes and controls	February 2016	Audit Planning Report
Interim testing	February 2016	
Year end audit	June/July 2016	
Completion of audit	August/September 2016	Report to those charged with governance via the Audit Results Report Audit report (including our opinion on the financial statements and overall value for money conclusion) Audit completion certificate Reporting to the NAO on the Whole of Government Accounts return
Conclusion of reporting	September 2016	Annual Audit Letter

3.4 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.

A breakdown of our agreed fee is shown below.

	Planned Fee 2015/16 £	Scale fee 2015/16 £	Outturn fee 2014/15 Prior auditor £
Opinion Audit and VFM Conclusion	93,264	93,264	124,352
Total Audit Fee – Code work	93,264	93,264	124,352
Certification of claims and returns	8,911	8,911	11,800
Non-audit work	-	-	3,000

All fees exclude VAT.

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

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ We can rely on the work of internal audit as planned;
- ▶ Our financial statement 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 and the PSAA in advance.

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

4. Audit approach



4.1 Review of internal controls

In devising our audit approach, we are required to gain an understanding of the controls within the Council's material financial systems.

This understanding was gained during our planning visit, during the weeks commencing 1 February 2016 and 8 February 2016, when we completed walkthrough testing of all material financial systems. This allowed us to identify and assess the key controls within each material financial system.

4.2 The Council's own assurance processes

We are also required to gain an understanding of the wider control environment within the Council. In order to gain this understanding we have held meetings with the finance team, including your systems accountant and wider IT support team, to ensure that our understanding of the systems and controls (including IT controls and the integrity of the IT applications) reflects the documentation and practices of the Council. This has allowed us to understand 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.

A key element of the monitoring of the control environment is the rolling programme of internal audit assignments and their testing of the effectiveness of controls. We have met regularly with internal audit, since becoming the Council's external auditors to gain a better understanding of the Council's control environment, and taken this into account when considering our audit approach.

4.3 Review of predecessor auditor file

As highlighted in our External Audit Transition report, which was presented to the Audit Committee on 18 December 2015, we completed our review of the predecessor auditor's 2014/15 audit file on 21 October 2015. This review allowed us to gain an understanding of complex transactions and accounting entries in previous years, as well as a more in depth understanding of the rationale behind their audit approach in the prior year.

4.4 Audit Approach

Based on the knowledge obtained from our planning procedures, we consider that the most efficient approach to the audit is to adopt a substantive approach supported by the use of data analytic tools.

Our rationale is that the use of a substantive approach will allow us to design and perform a combination of substantive analytic procedures and tests of detail that are more responsive to the identified financial statement and value for money risks.

5. Service delivery



5.1 Your audit team

Your audit team will consist of members of the specialist Government & Public Sector assurance team based in the North East and will be led by Nicola Wright. Nicola will be supported by Stuart Kenny, who is responsible for the day to day management of the audit. A summary of their role and experience is set out below.

Nicola Wright Executive Director Tel: (0191) 269 4887 Mobile: 07341 078397 Email: nwright1@uk.ey.com	Background <ul style="list-style-type: none">▶ Nicola is an Executive Director in EY's Government and Public Sector (GPS) Assurance team in the North East. She has 18 years of experience in public sector external audit across local government, the NHS, housing, education and charities sectors. Role on audit <ul style="list-style-type: none">▶ Nicola will be the Executive Director responsible for delivering the audit, including agreeing the Audit Planning Report and Annual Audit Letter, the quality of outputs and signing of opinions and conclusions.▶ She will also be responsible for liaison with Ada Burns, the Chief Executive, Paul Wildsmith, Director of Neighbourhood Services and Resources, and the Councillors, and attending all Audit Committee meetings.
Stuart Kenny Manager Tel: (0191) 269 6999 Email: skenny1@uk.ey.com	Background <ul style="list-style-type: none">▶ Stuart has specialised in public sector external audit for over seven years across local government, NHS, housing, education and charities. During this time he has been responsible for the delivery of several local government audits. Role on audit <ul style="list-style-type: none">▶ Stuart will be the Manager responsible for overseeing the external audit of the Council and will be the main contact for day to day communications with the management team.▶ Stuart will also attend all Audit Committee meetings alongside Nicola.

5.2 Data analytics

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

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

For our 2015/16 audit, we intend to focus our data analytic work on journal entries in the general ledger and payments made through the payroll system. We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit Committee.

5.3 Internal audit

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

5.4 Use of specialists

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

Area	Specialists
Valuation of land and buildings	Council's valuer EY property valuation specialists
Private Finance Initiative (PFI)	EY PFI specialist
Pensions liability	Aon Hewitt (Council Actuary) EY actuarial specialists

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.

Appendix A: Independence

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▶ 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.

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 audit fees and we have not undertaken any non-audit work.

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.

Relationships, services and related threats and safeguards (continued)

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 Nicola Wright, the audit Executive Director and the audit engagement team have not been compromised.

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

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

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

Appendix B: Other required communications

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

Required communication	Reference
<p>Planning and audit approach</p> <p>Communication of the planned scope and timing of the audit including any limitations.</p>	▶ Audit Planning Report
<p>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Significant difficulties, if any, encountered during the audit ▶ Significant matters, if any, arising from the audit that were discussed with management ▶ Written representations that we are seeking ▶ Expected modifications to the audit report ▶ Other matters if any, significant to the oversight of the financial reporting process 	▶ Audit Results Report
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ In writing, corrected misstatements that are significant 	▶ Audit Results Report
<p>Fraud</p> <ul style="list-style-type: none"> ▶ Enquiries of the Audit 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
<p>Related parties</p> <p>Significant matters arising during the audit in connection with the Council's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the entity 	▶ Audit Results Report
<p>External confirmations</p> <ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures 	▶ Audit Results Report
<p>Consideration of laws and regulations</p> <ul style="list-style-type: none"> ▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of 	▶ Audit Results Report
<p>Independence</p> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement director's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence 	▶ Audit Planning Report ▶ Audit Results Report

Required communication	Reference
<p>Going concern</p> <p>Events or conditions identified that may cast significant doubt on the Council's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	▶ Audit Results Report
Significant deficiencies in internal controls identified during the audit	▶ Audit Results Report
Fee Information	▶ Audit Planning Report
<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 	▶ Audit Results Report
Opening Balances (initial audits)	▶ Audit Results Report
<ul style="list-style-type: none"> ▶ Findings and issues regarding the opening balance of initial audits 	
Certification work	▶ Annual Report to those charged with governance summarising grant certification
<ul style="list-style-type: none"> ▶ Summary of certification work undertaken 	▶ Annual Audit Letter (if considered necessary)

Appendix C: Transition update

In our External Audit Transition briefing paper presented to the Audit Committee on 18 December 2015, we detailed our approach and progress with ensuring the Council received a smooth transition between auditors.

We have provided a further update in relation to our transition progress and the work we have completed so far.

Meetings

Since our external audit transition paper we have met with the following officers to continue the transition process:

- ▶ Ada Burns, Chief Executive - to discuss the challenges faced by the Council, including the Ofsted review and financial pressures.
- ▶ Paul Wildsmith, Director of Neighbourhood Services and Resources - to discuss the ongoing financial challenges faced by the Council.
- ▶ Suzanne Joyner, Director of Children & Adult Services - to discuss progress against the Ofsted findings.
- ▶ Guy Metcalfe, Head of Property Asset Management - to discuss the valuations process at the Council.

Walkthroughs and early testing

During our visits to the Council we have undertaken the following work, both to help us gain a better understanding of the Council, and also to facilitate a more efficient audit in the summer:

- ▶ Walkthroughs - we have completed system walkthroughs for all material financial systems.
- ▶ Expenditure testing - we have selected a sample of expenditure items for the period April to December 2015 in order to allow us to perform early testing.

Review of financial statements

We have reviewed the 2014/15 financial statements and provided comments to the finance team. These reviews have identified:

- ▶ Ways to reduce the size of the financial statements, through for example the identification of immaterial disclosures that can be removed, in order to help make the preparation of the financial statements less time consuming.
- ▶ Areas where we believe amendments are required to the financial statements in order to ensure compliance with the CIPFA Code of Practice.

We believe it is important to complete this review early so any outcomes can be addressed when preparing the 2015/16 financial statements.

Technical Training

On 11 February 2016, two members of our central technical team visited the Newcastle EY office and provided a training session on the latest accounting developments in the local government sector. The training included areas such as:

- ▶ IFRS 13 - Fair Value Measurement
- ▶ Group Accounting and the Better Care Fund
- ▶ Minimum Revenue Provision
- ▶ Highways Network Assets

Two members of the Council's finance team attended the training, which also provided a useful insight into the way other Councils in both the North East and further afield are dealing with local government specific issues.

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