Darlington Borough Council
Audit Planning Report

Year ended 31 March 2020

April 2020

EY
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April 2020

Audit Committee
Darlington Borough Council
Town Hall
Feethams
Darlington
DL1 5QT

Dear Audit Committee Members

Audit Planning Report

We are pleased to attach our Audit Planning Report, which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2019/20 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments Ltd (PSAA), auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This report summarises our assessment of the key issues which drive the development of an effective audit for the Council. Given recent developments in relation to Covid-19, this Audit Planning Report is provisional and summarises our initial assessment of the key risks driving the development of an effective audit for the Council and outlines our planned audit strategy in response to those risks. Our planning procedures in relation to Covid-19 remain ongoing; we will inform the Audit Committee if there are any significant changes or revisions once we have completed these procedures and will provide updates to subsequent meetings of the Committee.

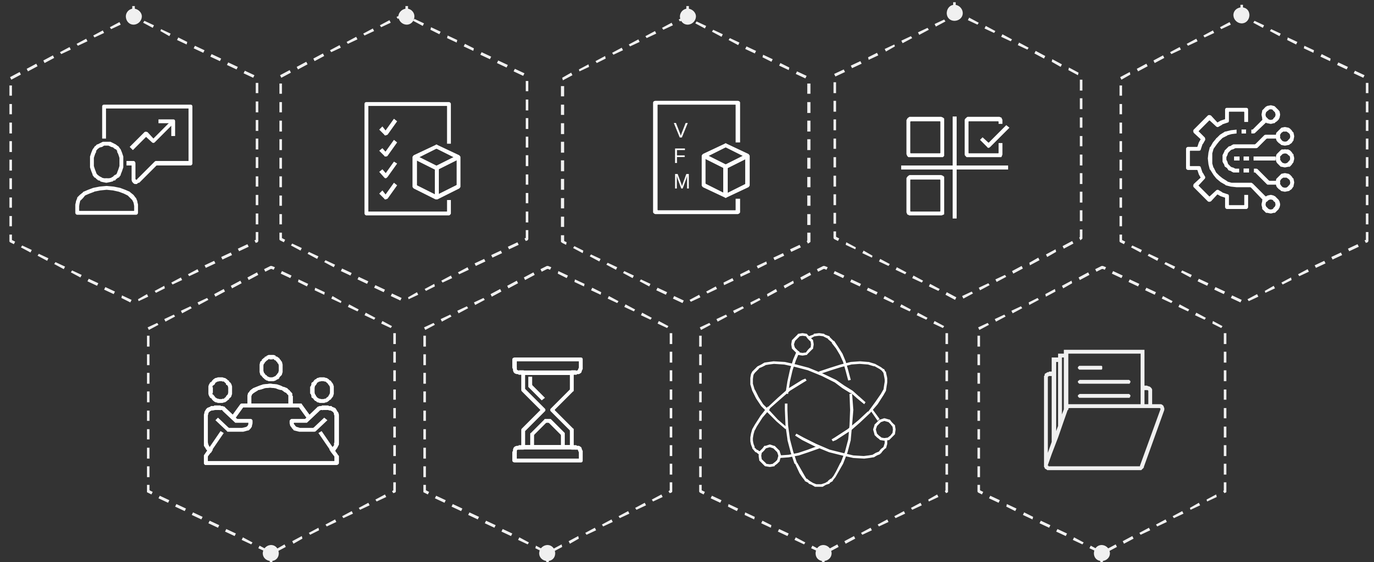
This report is intended solely for the information and use of the Audit Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Nicola Wright
Associate Partner
For and on behalf of Ernst & Young LLP

Contents



Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.
The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.
This report is made solely to the Audit Committee and management of Darlington Borough Council in accordance with the Statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Darlington Borough Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Darlington Borough Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2019/20 audit strategy

Overview of our 2019/20 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from prior year	Details
Risk of fraud in revenue and expenditure recognition	Fraud risk/ Significant risk	No change in risk or focus	Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.
Misstatements due to fraud or error	Fraud risk/ Significant risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.
Valuation of land and buildings and investment properties	Inherent risk	Reduced risk	Land and buildings are 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. As in previous years, this risk primarily relates to hard to value assets.
Pension liability valuation	Inherent risk	No change in risk or focus	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 can have a material impact on the balance sheet.
Group accounts	Inherent risk	No change in risk or focus	The Council is working in conjunction with Esh Homes Limited to develop four housing projects in the borough. The Council owns a 50% share in these projects, which are at various stages of completion. It is expected that these projects will deliver in excess of £3.6 million of pre-tax profits by 2026/27. The CIPFA Code requires the Council to consider both qualitative and quantitative factors of its joint arrangements to assess if group accounting is required to reflect the Council's share of the joint ventures in the financial statements.

Overview of our 2019/20 audit strategy

Audit risks and areas of focus			
Risk / area of focus	**Risk identified**	**Change from prior year**	**Details**
Financial sustainability	Significant value for money risk	No change in risk or focus	The Council continues to operate in a challenging financial environment. The main risks to the Council's finances are reductions in central government funding, increased reliance on locally raised taxes, increased budget pressures and increasing demands for services. In February 2020, the Council published its Medium Term Financial Plan (MTFP) for 2020/21 to 2023/24. The plan includes £10.3m of net pressures, which includes delivery of savings totalling £12.9m, over the duration of the plan. There is therefore significant pressure on the Council's finances over the coming years. We note that the above plan does not incorporate the potential financial impact of Covid-19, due to the timing of its production.

Overview of our 2019/20 audit strategy

Covid-19

Given recent developments in relation to Covid-19, the above table represents our provisional summary of our initial assessment of the key risks driving the development of an effective audit for the Council. We have set out our current views on the potential impact of Covid-19 in Section 2. However, we consider the likely impact to be pervasive across the financial statements.

Our planning procedures in relation to Covid-19 remain ongoing and we will inform the Audit Committee if there any significant changes or revisions once we have completed these procedures and will provide updates to subsequent meetings of the Committee.

Materiality

Planning materiality
£5.4m

Materiality has been set at £5.4m, which represents 2% of the prior year's gross expenditure on provision of services.

Performance materiality
£4.0m

Performance materiality has been set at £4.0m, which represents 75% of materiality.

Audit differences
£272k

We will report all uncorrected misstatements relating to the comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, housing revenue account and collection fund greater than £272,000. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Committee.

Overview of our 2019/20 audit strategy

Audit scope

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 Darlington Borough Council give a true and fair view of the financial position as at 31 March 2020 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

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

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

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

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

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

02 Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Risk of fraud in revenue and expenditure recognition*

Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. These accounts had the following balances in the 2018/19 financial statements:

Income Account: £256.4m

Expenditure Account: £272.3m

What is the risk?

Under ISA 240, there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

Our judgement is that the significant risk at the Council relates to the recognition of grants, the potential for improper capitalisation of revenue expenditure and the omission of expenditure in the financial statements. We will therefore target our audit work in these areas.

What will we do?

We plan to perform the following procedures to address the risk:

- Test a sample of capital grants to confirm that they have been recognised in accordance with agreed terms and conditions;
- Test a sample of capital additions to confirm they meet the criteria for capitalisation set out in accounting standards;
- Review minutes of Council, Cabinet and other key meetings to identify any potential accruals or provisions which may have been omitted from the financial statements; and
- Review a sample of transactions recorded in the general ledger and payments from the bank account post year end, to confirm that the associated income and expenditure has been recorded in the correct period.

Our response to significant risks (continued)

Misstatements due to fraud or error	What is the risk?	What will we do?
	The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA 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.	We plan to perform the following procedures to address the risk: • Identifying fraud risks during the planning stages. • Inquiry of management about risks of fraud and the controls put in place to address those risks. • Understanding the oversight given by those charged with governance of management's processes over fraud. • Consideration of the effectiveness of management's controls designed to address the risk of fraud. • Determining an appropriate strategy to address those identified risks of fraud. • Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements.

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures.

What is the risk/area of focus?	What will we do?
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	We will: • Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • Sample testing key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre); • Consider the annual cycle of valuations to ensure that assets have been valued within a five year rolling programme as required by the Code for PPE and annually for IP. We will considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer; • Consider changes to useful economic lives as a result of the most recent valuation; and • Test accounting entries have been correctly processed in the financial statements,
Pension Liability Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Durham County Council. The Council's Pension Fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2019, this totalled £168 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: • Liaise with the auditors of Durham County Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Darlington Borough Council; • Assess the work of the Pension Fund actuary including the assumptions they have used by relying on the work of PwC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and • Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Group Accounts In 2018/19, the Council produced Group accounts, in order to include the joint venture arrangements with Esh Homes Limited. The Council owns 50% of the share capital of the joint ventures in place. To assess if group accounting is required, the CIPFA Code requires an assessment of arrangements on a qualitative basis first, and then on a quantitative basis. Management should revisit the Group assessment annually, based on the most up-to-date information, to determine if the Group financial statements require additional entities to be incorporated within the consolidation.	We will: • Review the Council's Group boundary assessment to ensure that it is complete and all Group entities have been identified; • Review the Council's assessment of qualitative factors such as whether the Council is exposed to any commercial risk through its involvement with the potential Group entities, in order to ensure the assessment is appropriate; and • Test the Council's quantitative assessment by agreeing all values included in the assessment to audited financial statements for each of the potential Group entities.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Going Concern Compliance with ISA 570 This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after. The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the Council will be the audit of the 2020/21 financial statements. The revised standard increases the work we are required to perform when assessing whether the Council is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards, and we have therefore judged it appropriate to bring this to the attention of the Audit Committee. The CIPFA Guidance Notes for Practitioners 2019/20 accounts states 'The concept of a going concern assumes that an authority's functions and services will continue in operational existence for the foreseeable future. The provisions in the Code in respect of going concern reporting requirements reflect the economic and statutory environment in which local authorities operate. These provisions confirm that, as authorities cannot be created or dissolved without statutory prescription, they must prepare their financial statements on a going concern basis of accounting.' 'If an authority were in financial difficulty, the prospects are thus that alternative arrangements might be made by central government either for the continuation of the services it provides or for assistance with the recovery of a deficit over more than one financial year. As a result of this, it would not therefore be appropriate for local authority financial statements to be provided on anything other than a going concern basis.'	The revised standard requires: • Auditor's challenge of management's identification of events or conditions impacting going concern, more specific requirements to test management's resulting assessment of going concern, an evaluation of the supporting evidence obtained which includes consideration of the risk of management bias; • Greater work for us to challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence we obtained and evaluate the risk of management bias. Our challenge will be made based on our knowledge of the Council obtained through our audit, which will include additional specific risk assessment considerations which go beyond the current requirements; • Improved transparency with a new reporting requirement for public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work we have done in this respect. While the Council are not one of the three entity types listed, we will ensure compliance with any updated reporting requirements; • A stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when we draw our conclusions on going concern; and • Necessary consideration regarding the appropriateness of financial statement disclosures around going concern. The revised standard extends requirements to report to regulators where we have concerns about going concern. We will discuss the detailed implications of the new standard with finance staff during 2019/20 ahead of its application for 2020/21.

Other areas of audit focus (continued)

Impact of Covid-19

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

- Going concern – management's assessment of whether the Council is a going concern will need to consider the impact of the current conditions on the Council's future performance. Additional narrative disclosure will be required, including on the future principal risks and uncertainties, including the impact on operations for 2020/21 and beyond.
- Revenue recognition – there may be an impact on income collection (Council and Business rates) if businesses and residents are unable to work and earn income due to the lockdown and restriction of movement due to COVID-19.
- Tangible assets – there may be impairment of tangible assets if future service potential is reduced by the economic impact of the virus. The Council may also have already incurred capital costs on projects where the economic case has fundamentally changed.
- Pensions – volatility in the financial markets is likely to have a significant impact on pension assets, and therefore net liabilities.
- Receivables – there may be an increase in amounts written off as irrecoverable and impairment of year-end balances due to the increased number of businesses and residents unable to meet their financial obligations.
- Government support – any Covid-19 specific government support is likely to be a new transaction stream and may require development of new accounting policies and treatments.
- Annual Governance Statement– the widespread use of home working is likely to change the way internal controls operate. The Annual Governance Statement will need to capture how the control environment has changed during the period and what steps were taken to maintain a robust control environment during the disruption. This will also need to be considered in the context of internal audit's ability to issue their Head of Internal Audit opinion for the year, depending on the ability to complete the remainder of the internal audit programme.

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

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

03 Value for money risks

Value for money risks

Background

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. This is known as our value for money conclusion.

For 2019/20, this is based on the overall evaluation criterion:

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

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

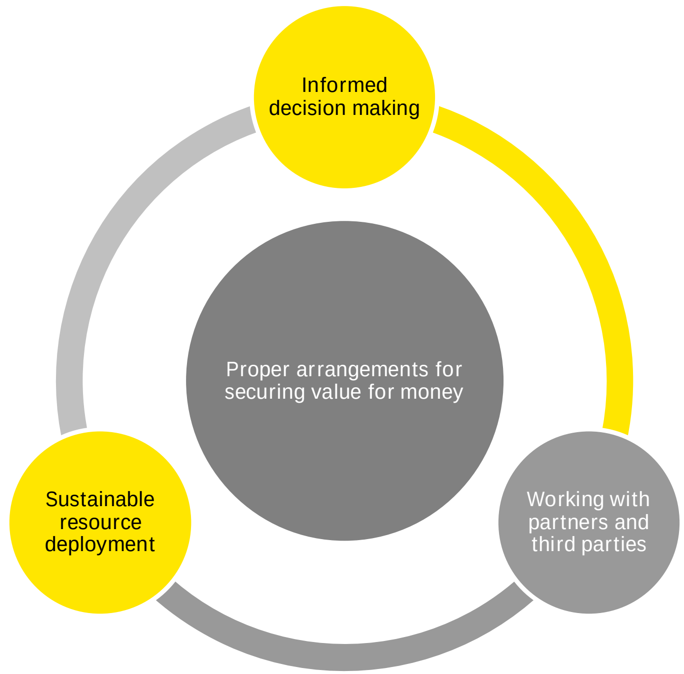
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your Annual Governance Statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level.

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



Value for money risks

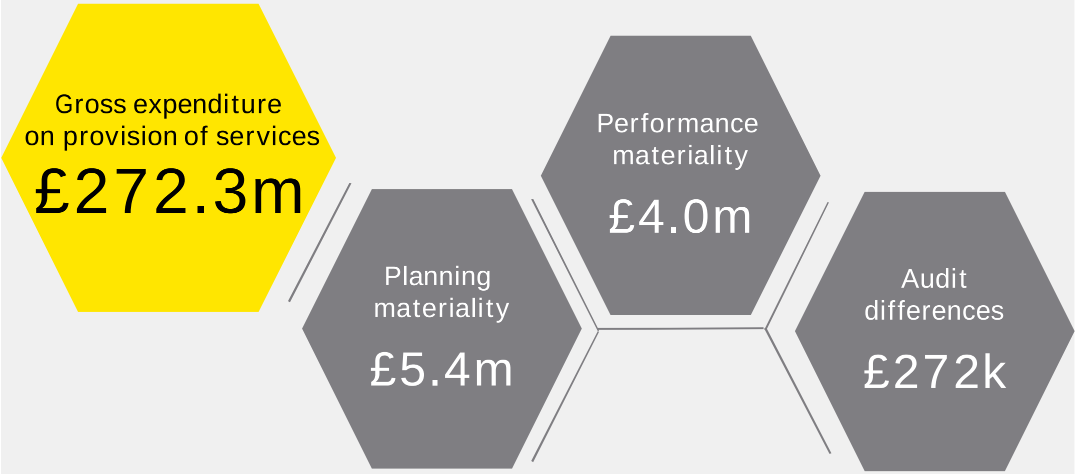
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Financial sustainability	The Council continues to operate in a challenging financial environment. The main risks to the Council's finances are reductions in central government funding, increased reliance on locally raised taxes, increased budget pressures and increasing demands for services. In February 2020, the Council published its Medium Term Financial Plan (MTFP) for 2020/21 to 2023/24. The plan includes £10.3m of net pressures, which includes delivery of savings totalling £12.9m, over the duration of the plan. There is therefore significant pressure on the Council's finances over the coming years. We note that the above plan does not incorporate the potential financial impact of Covid-19, due to the timing of its production.	Our approach will focus on: • Select a sample of cost reduction plans and assess their reasonableness, including testing of the assumptions used; • Review the level of reserves to ensure they are sufficient to cover the Council's assessment of the minimum required to provide its statutory services; and • Review the medium term financial plan and test the reasonableness of a sample of the assumptions used.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2019/20 has been set at £5.4m. This represents 2% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



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

Key definitions

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

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £4.0m which represents 75% of planning materiality. We have used a threshold of 75% as our experience from prior year audits means that we do not anticipate identifying a significant number of audit adjustments.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. The same threshold for misstatements is used for component reporting. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, housing revenue account and collection fund greater than £272k.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Audit Committee, or are important from a qualitative perspective.

05 Scope of our audit

Our audit process and strategy

Objective and scope of our audit

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

We issue an audit report that covers:

1. Financial statements audit

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

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

Procedures required by standards

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

Procedures required by the Code

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

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

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

Our audit process and strategy (continued)

Audit process overview

Our audit involves:

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

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

Analytics

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

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

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

Internal audit

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

Scoping the Group audit

Group scoping

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

1. Significant components: A component is significant when it is likely to include risks of material misstatement to the Group financial statements, either because of its relative financial size to the Group (quantitative criteria), or because of its specific nature or circumstances (qualitative criteria). We generally assign significant components a full or specific scope given their importance to the financial statements; or

2. Not significant components: The number of additional components and extent of procedures performed depended primarily on: evidence from significant components, the effectiveness of group wide controls and the results of analytical procedures.

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

Scoping by entity

Our preliminary audit scopes that we have determined are set out below. Note that these apply only for the purposes of the consolidated financial statements.

Darlington Borough Council	Full Scope
Eastbourne Joint Venture	Specific Scope
Heighington Joint Venture	Specific Scope
Middleton St George JV Limited	Specific Scope
West Park Limited	Specific Scope

Scope definitions

Full scope: components where a full audit is performed to the materiality levels assigned by the Group audit team for purposes of the consolidated audit. In this case, the procedures performed will also support our opinion on the Council's stand-alone financial statements.

Specific scope: components where the audit is limited to specific accounts or disclosures identified by the Group audit team based on the size and/or risk profile of those accounts. Our planning procedures have identified the following accounts as potentially material to the Group financial statements:

- Expenditure;
- Income; and
- Balance sheet items such as property, plant and equipment.

Group audit team involvement in component audits

Auditing standards require us to be involved in the work of our component teams. We will issue instructions to PwC, setting out the information that we require from them to support our work on the Group audit opinion.

06 Audit team

Audit team

Steve Clark is the Partner responsible for the overall quality and delivery of the audit service. He will be supported by Vusi Maseko as Manager on the audit, who will be the main point of contact for the finance team.

Use of specialists

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

Area	Specialists
Valuation of Land and Buildings	EY Valuations Team – Review the valuation report prepared by Align Property Services
Pensions disclosure	EY Actuaries – Review of pension report prepared by PwC

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

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

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

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2019/20.

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

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	December	Audit Committee	
Walkthrough of key systems and processes and Interim audit testing	January		
Interim audit testing	February		
	March		
	April	Audit Committee	Audit Planning Report
	May		
Year end audit Audit Completion procedures	July		
	September	Audit Committee	Audit Results Report Audit opinions and completion certificates

08 Independence

Independence

Introduction

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

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

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

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

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

Relationships, services and related threats and safeguards

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

Overall assessment

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

Self interest threats

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

At the time of writing, there are no long outstanding fees, limited non-audit services (relating to grant claims) and no business relationships.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

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

Self review threats

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

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

Management threats

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

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

Other threats

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

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

New UK Independence Standards

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

Summary of key changes

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

Next Steps

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

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

Other communications

EY Transparency Report 2019

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

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the period ended 28 June 2019 (published September 2019):

https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2019/ey-uk-2019-transparency-report.pdf

09 Appendices

Appendix A

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Planned fee 2019/20	Scale fee 2019/20	Final Fee 2018/19
	£	£	£
Total Fee – Code work	71,813	71,813	71,813
Scale fee variation for group accounting and the impact of McCloud	-	-	3,553*
Total audit	71,813**		75,366
Non-audit work – Housing benefits certification work	TBC***	-	9,500
Non-audit work – Teachers' pension certification work	TBC***	-	3,400
Non-audit work – Home England Grant	TBC***	-	8,000
Non-audit work – Pooling of capital receipts	TBC***	-	3,500
Total other non-audit services	TBC		24,400
Total fees	71,813		99,766

*(1) We have requested a scale fee variation for the additional work undertaken in respect of Group accounting and pensions in 2018/19. This fee has been agreed with officers and we have informed the PSAA.

**(2) We wrote to management and the Audit Committee Chair on 10 February 2020 setting out our considerations on the sustainability of UK local public audit. A base fee of £71,813 has been prescribed by PSAA for the 2019/20 audit but we will be having further discussions with management and the Audit Committee on the level of scale fee variation to be applied. Some of the factors relevant to this discussion are set out on the next slide.

***(3) We will agree fees with you for 2019/20 certification work prior to commencing the work.

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the Council; and
- The Council has an effective control environment.

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

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

Fees

Summary of key factors

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

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

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

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

   We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality. We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.

To respond to these factors we have to:

- Increase our sample sizes, seek higher levels of corroborative evidence and engage with our internal specialists on a wider array of matters;
- Increase our investment in data analytics tools to allow us to test more transactions to a greater level of detail and enhance audit quality; and
- Invest in our audit quality infrastructure, as a firm our compliance costs have doubled as a proportion of revenue over the past five years.

Appendix B

Required communications with the Audit Committee

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

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

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	Audit Results Report, July 2020
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	Audit Results Report, July 2020
Fraud	• 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, July 2020
Related parties	• Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	Audit Results Report, July 2020

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you: When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report, April 2020 Audit Results Report, July 2020
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report, July 2020
Consideration of laws and regulations	• Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	Audit Results Report, July 2020
Internal controls	• Significant deficiencies in internal controls identified during the audit	Audit Results Report, July 2020

Appendix B

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Group audits	• An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work • Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Audit Planning Report, April 2020 Audit Results Report, July 2020
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report, July 2020
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report, July 2020
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report, July 2020
Fee Reporting	• Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Audit Planning Report, April 2020 Audit Results Report, July 2020
Certification work	Summary of certification work undertaken	Certification Report

Additional audit information

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

Appendix C

Additional audit information (continued)

Purpose and evaluation of materiality

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

Materiality determines:

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

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

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