

Darlington Borough Council

Annual Audit Letter for the year
ended 31 March 2019

August 2019

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing downwards towards the letters.

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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psa.co.uk).

This 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 (updated April 2018)' issued by PSAA set 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 Annual Audit Letter is prepared in the context of the Statement of responsibilities and Terms of Appointment. It is addressed to the Members of the audited body, and is prepared for their sole use. 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.



01 Executive Summary



Executive Summary

We are required to issue an Annual Audit Letter to Darlington Borough Council (“the Council”) following completion of our audit procedures for the year ended 31 March 2019.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council’s:	Unqualified - the financial statements give a true and fair view of the financial position of the Council as at 31 March 2019 and of its expenditure and income for the year then ended.
▶ Financial statements	
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the financial statements.
Concluding on the Council’s arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Annual Governance Statement	The Annual Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council’s Whole of Government Accounts return (WGA)	The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the consolidation pack.

Executive Summary (continued)

As a result of the areas on the previous page, we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit	Our Audit Results Report was presented to the Audit Committee on 31 July 2019.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice	Our certificate was issued on 31 July 2019.

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

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



02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this Annual Audit Letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2018/19 Audit Results Report to the 31 July 2019 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2018/19 audit work has been undertaken in accordance with the Audit Planning Report that we issued in March 2019 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2018/19 financial statements; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the Annual Governance Statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

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

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



03

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office, and issued an unqualified audit report on 31 July 2019.

Our detailed findings were reported to the 31 July 2019 Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risks

Misstatements due to fraud or error

As identified in auditing standards, 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.

Conclusion

We performed the following testing in relation to this risk:

- ▶ We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;
- ▶ We reviewed accounting estimates for evidence of management bias (as noted below relating to revenue and expenditure recognition); and
- ▶ We evaluated the business rationale for any significant unusual transactions.

We did not identify any transactions during our audit which appeared unusual or outside of the Council's normal course of business.

We did not identify any instances of inappropriate judgements being applied.

Financial Statement Audit (continued)

Significant Risk	Conclusion
<p>Risk of fraud in revenue and expenditure recognition</p> <p>Under auditing standards, 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.</p> <p>Local authorities have a statutory duty to balance their annual budget and are operating in a financially challenged environment with reducing levels of government funding and increasing demand for services. Achievement of budget is critical to minimising the impact and usage of the Council's usable reserves and provides a basis for the following year's budget. Any deficit outturn against the budget is therefore not a desirable outcome for the Council and management, and therefore this desire to achieve budget increases the risk that the financial statements may be materially misstated.</p>	<p>We performed the following testing in relation to this risk:</p> <ul style="list-style-type: none"> ▶ We reviewed and tested revenue and expenditure recognition policies; ▶ We reviewed, discussed with management and tested (where appropriate) any accounting estimates on revenue or expenditure recognition for evidence of bias; ▶ We tested a sample of additions to Property, Plant and Equipment assets to obtain assurance that the spend was capital in nature; ▶ We tested a sample of capital grants and contributions to confirm that terms and conditions had been met and recognition of revenue was appropriate; and ▶ We reviewed a sample of transactions recorded in the ledger and payments made from the bank account post year-end and confirmed that the associated income and expenditure had been recorded in the correct period. <p>Our testing did not identify any material misstatements relating to revenue and expenditure recognition.</p> <p>We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.</p>
<p>Valuation of land and buildings</p> <p>The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges.</p> <p>Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>	<p>We performed the following testing in relation to this risk:</p> <ul style="list-style-type: none"> ▶ We considered the work performed by the Council's external valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; ▶ We sample tested key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre); ▶ We considered the annual cycle of valuations to ensure that assets have been valued within a five year rolling programme as required by the CIPFA Code; ▶ We reviewed assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated; ▶ We considered changes to useful economic lives as a result of the most recent valuation; and ▶ We tested accounting entries to ensure they had been correctly processed in the financial statements. <p>We did not identify any material misstatements in relation to the valuation of land and buildings.</p>

Financial Statement Audit (continued)

Other Key Findings	Conclusion
<p>Pension liability valuation</p> <p>The Local Authority Accounting Code of Practice and accounting standards (IAS19) require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme. 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.</p> <p>The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Council.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. Auditing standards require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>We performed the following testing in relation to this risk:</p> <ul style="list-style-type: none"> ▶ We liaised with the auditor for Durham County Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to the Council; ▶ We assessed the work of the Pension Fund actuary including the assumptions they have used by relying on the work of the Consulting Actuaries commissioned by PSAA for all Local Government sector auditors, and considered any relevant reviews by the EY actuarial team; ▶ We liaised with the Council and our actuarial team to assess the reasonableness of additional pension liabilities recognised in the accounts this year, arising as a result of the McCloud judgement and Guaranteed Minimum Pension equalization; and ▶ We reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. <p>During the audit period, a material adjustment relating to the McCloud judgement was identified, which has impacted upon all Local Government Pension Scheme Scheduled Bodies. The Council instructed their actuary to revisit the Pension Liability values they previously provided to include the impact of both the McCloud judgement and Guaranteed Minimum Pension as well as updated asset values. The revised Pension Values provided by the actuary saw the Pension Liability increase by £7.2m between the draft and final financial statements.</p>
<p>Implementation of new accounting standards</p> <p>The Local Authority Accounting Code of Practice required the Council to implement IFRS9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers) for the first time in 2018/19.</p> <p>The implementation of IFRS 9 changed how financial assets are classified and measured, how the impairment of financial assets is calculated, and the disclosure requirements for financial assets.</p> <p>The impact of IFRS 15 was expected to be limited as large revenue streams like council tax, non domestic rates and government grants are outside the scope of the standard.</p>	<p>We performed the following testing in relation to this risk:</p> <ul style="list-style-type: none"> ▶ We obtained a copy of the impact assessment for IFRS 9 and 15 prepared by management and noted that there was not expected to be a material impact on the financial statements; ▶ We considered the impact of IFRS 9 and 15 as we performed our audit work on the financial statements to satisfy ourselves that there was no further impact of the new standards that had not been recognised or disclosed by management; and ▶ We completed the CIPFA disclosure checklist to satisfy ourselves that all of the relevant disclosures were included in the accounts. <p>We did not identify any material issues with the implementation of the new accounting standards.</p>

Financial Statement Audit (continued)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £5.3m (2017/18: £5.1m), which is 2% of gross expenditure on the provision of services reported in the accounts.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.265m (2017/18: £0.257m).</p>



04 Value for Money

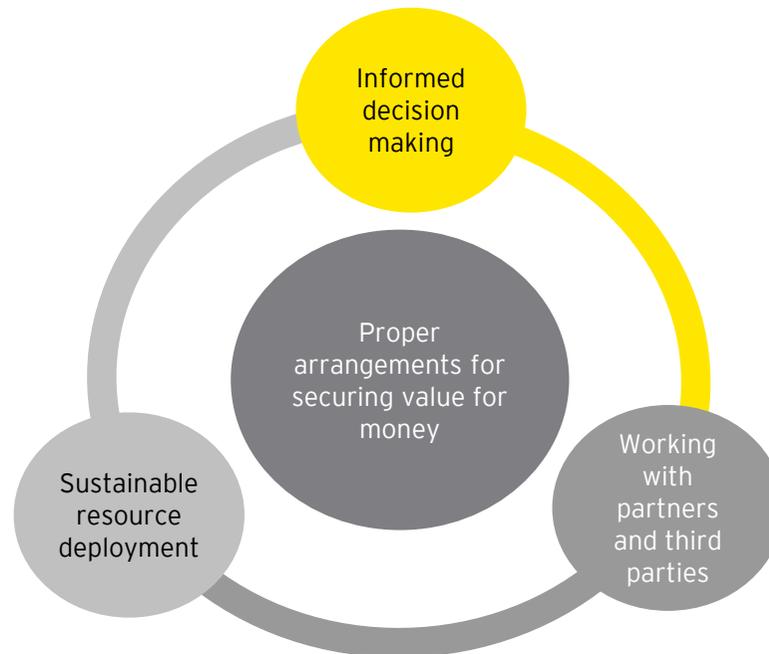
£ Value for Money

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.

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.



Overall conclusion

We identified one significant risk around the value for money arrangements as part of our Audit Planning Report. The table on the following page presents our findings in response to this risk. We did not identify any further significant risks or weaknesses after the audit planning phase.

Based on the work performed we have no matters to report about your arrangements to secure economy, efficiency and effectiveness in the use of resources and issued an unqualified value for money conclusion.

Value for Money (continued)

What is the significant value for money risk?

Deploying resources in a sustainable manner

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 2019, the Council published its Medium Term Financial Plan (MTFP) for 2019/20 to 2022/23.

The plan includes £9.1m of net pressures, which includes delivery of savings totalling £5.1m, over the duration of the plan.

There is therefore significant pressure on the Council's finances over the coming years.

What are our findings?

We reviewed the year end financial performance of the Council and noted that useable reserves have increased in 2018/19. We have also considered the level of reserves held by the Council in the context of the budgeted savings required over the life of the MTFP and have not identified any concerns over the viability of the Council.

We reviewed and challenged some of the key assumptions in the MTFP and did not identify any specific areas of concern.

We tested a sample of documentation to support the Cost Recovery Plans developed by the Council to check that plans were in place for delivering savings. We had no findings to raise in this area.

Overall we were satisfied that the Council has appropriate arrangements in place for deploying financial resources.



05 Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2018/19 financial statements from members of the public.

Other Reporting Issues (continued)

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 31 July 2019. In our professional judgement, the firm is independent and the objectivity of the audit engagement associate partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

Control Themes and Observations

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.



06

Focused on Your Future



Focused on Your Future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard, IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>
IASB Conceptual Framework	<p>The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>This introduces;</p> <ul style="list-style-type: none"> - new definitions of assets, liabilities, income and expenses; - updates for the inclusion of the recognition process and criteria and new provisions on derecognition; - enhanced guidance on accounting measurement bases; and - enhanced objectives for financial reporting and the qualitative aspects of financial information. <p>The Conceptual Framework is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards.</p> <p>However, an understanding of concepts and principles can be helpful to preparers of Local Authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.</p>	<p>It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements.</p> <p>However, authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.</p>



07 Audit Fees

Audit Fees

Our base audit fee for 2018/19 is in line with the scale fee set by Public Sector Audit Appointments and reported in our Audit Results Reports for the Council.

	Final Fee 2017/18	Planned Fee 2018/19	Scale Fee 2018/19
	£	£	£
Audit Fee - Code work	93,264	71,813	71,813
Audit Fee - scale fee variation for group accounting and the impact of additional pension work	-	TBC*	-
Total audit fee - Code work	93,264		71,813
Non-audit work - Housing Benefit Subsidy Claim	8,911	TBC**	N/A
Non-audit work - Other certification work	11,200	TBC**	N/A
Total non-audit services	20,011		N/A

* We anticipate a variation to the scale fee being required in 2018/19 to take into account that this is the first year of group accounts and the significant amendments that were required to the accounts for the McCloud judgement (pension liability). We are in the process of agreeing these fees with management.

** Housing Benefit Subsidy Claim and other certification fees to be agreed when work commences

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