



Audit planning report 2019/20  
South Derbyshire District Council

Year ended 31 March 2020  
16 March 2020



Private and Confidential  
Audit-Sub Committee  
South Derbyshire District Council  
Civic Way  
Swadlincote  
DE11 0AH

16 March 2020

Dear Committee Members

External Audit planning report 2019/20

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit-sub 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 (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned to your expectations.

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

This report is intended solely for the information and use of the Audit-sub Committee and senior management of the Council, 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 on 25 March 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Helen Henshaw  
Associate Partner  
For and on behalf of Ernst & Young LLP

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# 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-Sub Committee and management of **South Derbyshire District 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 South Derbyshire District 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-Sub Committee and management of South Derbyshire District 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-sub 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 py                                 | Details  |
|---|--|--|--|
| Risk of fraud in revenue and expenditure recognition                  | Fraud risk/<br>Significant risk              | No change in risk or focus from the prior year | 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. See page 9 for details.   |
| Misstatements due to fraud or error                                   | Fraud risk                                   | No change in risk or focus from the prior year | 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. Further details are outlined at page 10.   |
| Valuation of property, plant and equipment (PPE) – land and buildings | Higher inherent risk and area of audit focus | No change in risk or focus from the prior year | PPE accounts for a significant proportion of the Council's assets (£143m at 31 March 2019). The valuation of land and buildings is subject to a number of assumptions and judgements by management's expert. There is a risk that the use of inappropriate assumptions or methodologies may have a material impact on the financial statements. Further details are on page 11.  |
| Local Government Pension scheme (LGPS)                                | Higher inherent risk and area of audit focus | No change in risk or focus from the prior year | <p>Funding of the Council's participation in the LGPS will continue to have an impact on both its cash flows and the liability in the balance sheet.</p> <p>The Council is a members of the LGPS, administered by Derbyshire Pension Fund. The net pension liability was £41.7 million as at 31 March 2019.</p> <p>The estimation of the defined benefit obligations is sensitive to a range of assumptions such as rates of pay and pension inflation, mortality and discount rates. The pension fund valuations requires advice from an external specialists, to provide these actuarial assumptions. A small movement in these assumptions could have a material impact on the value in the balance sheet. Further details are provided at page 12.</p> |
| IFRS 16 – accounting for leases                                       | Area of audit focus                          | New area of focus                              | Although the new standard will not be included in the CIPFA Code of Practice until 2020/21, work will be necessary to secure information required to enable authorities to fully assess their leasing position and ensure compliance with the standard from 1 April 2020. As you will be required to include the estimated impact of IFRS16 within your 2019/20 financial statements, you will need to provide evidence to demonstrate that an impact assessment has been undertaken, it is complete, and that any disclosures are free from material misstatement. Further details are provided at page 13.   |

# Overview of our 2019/20 audit strategy

## Audit scope

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

- Our audit opinion on whether the financial statements of South Derbyshire District 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.

## Audit team changes

Key changes to our team.

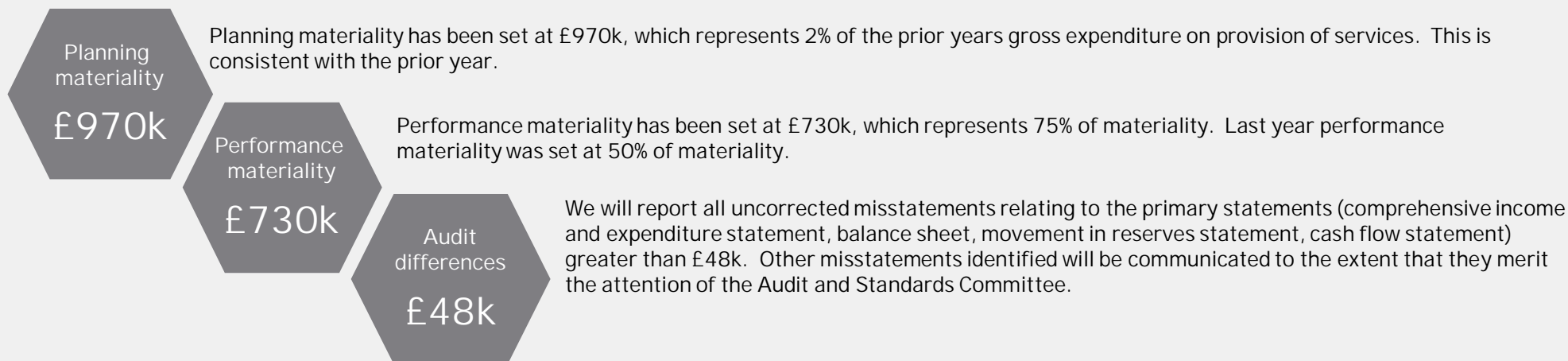


Helen Henshaw (CPFA, ACA) – Associate Partner

Helen will be taking on the engagement lead role for 2019/20. Helen has over 20 year's audit experience across the public and private sector. She now specialises in public sector audit, serving a portfolio of Health and Local Government clients.

# Overview of our 2019/20 audit strategy

## Materiality



## Audit Timetable

Janet Dawson, the UK Government and Public-Sector Assurance Leader for Ernst & Young LLP wrote to all Chief Financial Officers and Audit Committee Chairs for PSAA audited bodies in February 2020 setting out our views on the sustainability of UK local public audit.

At the end of January 2020, 85 organisations had not yet received their audit opinion on the 2018-2019 financial statements. The factors that have led to this unprecedented position are extensive, impact all audit suppliers in the PSAA contract and need to be considered by public sector finance professionals and Audit Committees. In summary, the types of issues and challenges we have seen include:

- Financial reporting and decision making in local government has become increasingly complex.
- Some local authorities have a shortage of financial reporting skills, capabilities and weaknesses in audit readiness (including keeping pace with technological advancement in data management and processing for audit).
- There has been a significant increase in the specialised skills, time and cost required by auditors to address regulatory expectations.
- 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.

To ensure we deliver the best quality audits, the PSAA, NAO and Local Public Audit Stakeholder forum have been informed that we will be scheduling a number of 2019/20 external audits for completion after the 31st July 2020. One of these is South Derbyshire District Council. The main driver of this decision was our desire to retain audit team continuity as far as possible to assist the delivery of an efficient, high quality audit. It does not reflect on the audit readiness of the Council.

The requirements of the Accounts and Audit Regulations 2015 are to publish a statement of accounts, annual governance statement and narrative statement by the 31st July with or without an audit opinion. If you are not able to publish an audit opinion at that time, you should explain why. This means the 31st July is not a statutory audit deadline. We will work with management to ensure that the publication requirements are met. Further details on the timetable can be found in section 7 of this report.



## 02 Audit risks



## 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

We consider the risk applies to:

- Inappropriate capitalisation of revenue expenditure and could result in a misstatement of cost of services reported in the comprehensive income and expenditure statement; and
- Inappropriate cut-off of revenue expenditure and non-grant income at the year-end date resulting in transactions being recorded in the wrong financial period.

#### 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 audit approach

In order to address this risk we will carry out a range of procedures including:

- Reviewing the appropriateness of expenditure recognition and capitalisation accounting policies;
- Testing the year end cut-off of expenditure and non-grant income to ensure that transactions have been recorded in the appropriate financial period;
- Using our data analytics tool to identify and test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statement, specifically those that move expenditure to PPE balance sheet general ledger codes; and
- Performing sample testing on additions to PPE to ensure that they have been correctly classified as capital and included at the correct value to identify any revenue items that have been inappropriately capitalised.



## Audit risks

### Our response to significant risks (continued)

Misstatements due to fraud or error\*

#### What is the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA (UK) 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.

#### What will we do?

- 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.



# Audit risks

## 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?  | Our audit approach?  |
|--|--|
| <p>Valuation of land and buildings</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. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p> <p>The fair value of other land and buildings represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges.</p> <p>The Council land and building assets are annually valued, and are subject to a number of assumptions and judgements, which if inappropriate could result in a material impact on the financial statements</p> | <p>We will;</p> <ul style="list-style-type: none"> <li>• Document our understanding of the processes and controls in place to mitigate the risks identified, and walk through those processes and controls to confirm our understanding</li> <li>• Evaluate the competence, capabilities and objectivity of management's specialist.</li> <li>• Review the terms of engagement or instructions issued to the valuer to ensure these are consistent with accounting standards. And assess if the instruction includes a specific instruction from the council to the valuer relating to an assessment on the unvalued population;</li> <li>• Consider the work performed by the Council's external valuer, including the adequacy and scope of the work performed.</li> <li>• Perform a sample test the asset data used by the valuer over the completeness and appropriateness of information provided to the valuer in performing their valuations (e.g. floor plans to support valuations based on a price attributed to area measurements);</li> <li>• Review the classification of assets and ensure the correct valuation methodology has been applied.</li> <li>• Consider changes to useful economic lives as a result of the most recent valuation;</li> <li>• Test the accounting entries have been correctly processed and recorded in the financial statements; and</li> <li>• Review any assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated;</li> </ul> |

## Audit risks

### Other areas of audit focus (continued)

| What is the risk/area of focus?  | Our audit approach   |
|--|--|
| <p>Pension Liability Valuation - LGPS</p> <p>The Local Authority Accounting Code of Practice and IAS19 require extensive disclosures within the financial statements regarding membership of the Local Government Pension Scheme administered by Derbyshire County Council.</p> <p>The information disclosed is based on the IAS 19 report issued to the Council by the actuaries to the County Council. Accounting for these schemes involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates</p> | <p>We will:</p> <ul style="list-style-type: none"><li>• Liaise with the auditors of Derbyshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to South Derbyshire District Council;</li><li>• Assess the work of the Pension Fund actuary (Hymans Robertson) 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</li><li>• Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.</li></ul> |

## Other areas of audit focus (continued)

### What is the risk/area of focus?

#### IFRS16 - leases

IFRS 16 Leases was issued by the IASB in 2016. Its main impact is to remove (for lessees) the traditional distinction between finance leases and operating leases. Finance leases have effectively been accounted for as acquisitions (with the asset on the balance sheet, together with a liability to pay for the asset acquired). In contrast, operating leases have been treated as “pay as you go” arrangements, with rentals expensed in the year they are paid. IFRS 16 requires all substantial leases to be accounted for using the acquisition approach, recognising the rights acquired to use an asset.

Implementation of IFRS 16 will be included in the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) for 2020/21. This Code has yet to be published, but in July 2019 CIPFA/LASAAC issued ‘IFRS 16 leases and early guide for practitioners’.

This early guidance provides comprehensive coverage of the requirements of the forthcoming provisions, including:

- ▶ the identification of leases
- ▶ the recognition of right-of-use assets and liabilities and their subsequent measurement
- ▶ treatment of gains and losses
- ▶ derecognition and presentation and disclosure in the financial statements,
- ▶ the management of leases within the Prudential Framework.

The guidance also covers the transitional arrangements for moving to these new requirements, such as:

- ▶ the recognition of right-of-use assets and liabilities for leases previously accounted for as operating leases by lessees
- ▶ the mechanics of making the transition in the 2020/21 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).

### What will we do?

IFRS 16 - leases introduces a number of significant changes which go beyond accounting technicalities. For example, the changes have the potential to impact on procurement processes as more information becomes available on the real cost of leases.

The key accounting impact is that assets and liabilities in relation to significant lease arrangements previously accounted for as operating leases will need to be recognised on the balance sheet.

Although the new standard will not be included in the CIPFA Code of Practice until 2020/21, work will be necessary to secure information required to enable authorities to fully assess their leasing position and ensure compliance with the standard from 1 April 2020.

In particular, full compliance with the revised standard for 2020/21 is likely to require a detailed review of existing lease and other contract documentation prior to 1 April 2020 in order to identify:

- ▶ all leases which need to be accounted for
- ▶ the costs and lease term which apply to the lease
- ▶ the value of the asset and liability to be recognised as at 1 April 2020 where a lease has previously been accounted for as an operating lease.

We will discuss progress made in preparing for the implementation of IFRS 16 - leases with the finance team over the course of our 2019/20 audit.

## Other matters

### What is the area of focus?

#### 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.'

### What will we do?

#### 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.



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## Value for Money Risks





# Value for Money

## Background

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

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.

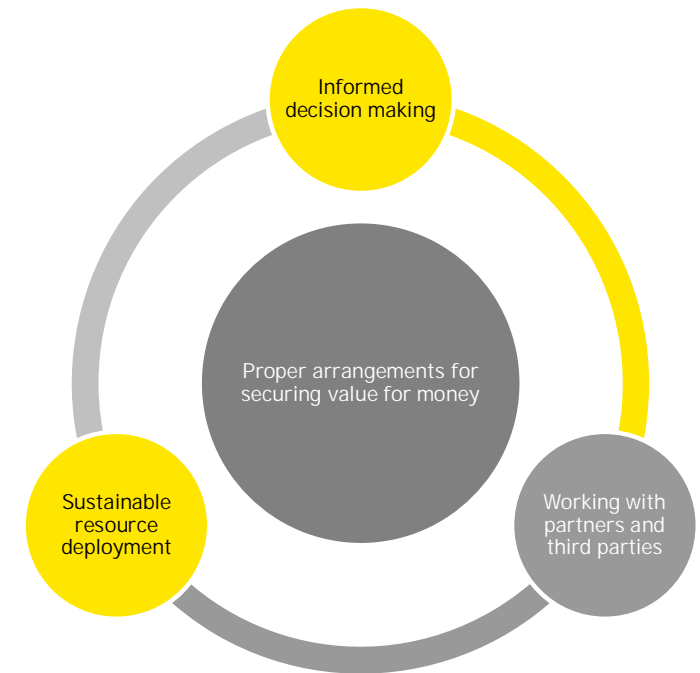
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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. In 2019/20 this has included consideration of the steps taken by the Council to consider medium-term financing and investment.

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. Our risk assessment is ongoing, but thus far has resulted in the identification of the significant risks noted on the following page which we view as relevant to our value for money conclusion.





# Value for Money Significant Risks

| What is the significant value for money risk?  | What arrangements does the risk affect?   | Our audit approach  |
|--|---|---|
| <p>Securing financial resilience</p> <p>Review of the updated of the medium term financial strategy (MTFS) reported to Finance and Management Committee on 13 February 2020, outlines that the Council has forecasted budget deficits from 2020/21 to 2024/25, ranging from £0.76m to £1.4m, respectively. These gaps will require the Council to will require a draw its general fund reserves. The impact is the general fund reserve will fall from £8.5m to 2.1m, over that period but remaining above the Council's minimum level threshold of £1m.</p> | <p>Deploy resources in a sustainable manner</p> <p>Planning resources effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.</p> | <p>We plan to:</p> <ul style="list-style-type: none"><li>▪ Review the detail of the revised MTFS including assessing the adequacy of the major assumptions used including the Council's plans to update the MTFS following the announcement in the March budget to suspend business rates for small businesses in the retail and leisure sectors.</li><li>▪ Review the Council's arrangements to develop a robust savings plan to address the future financial challenges and maintain an adequate level of reserves.</li></ul> |



04

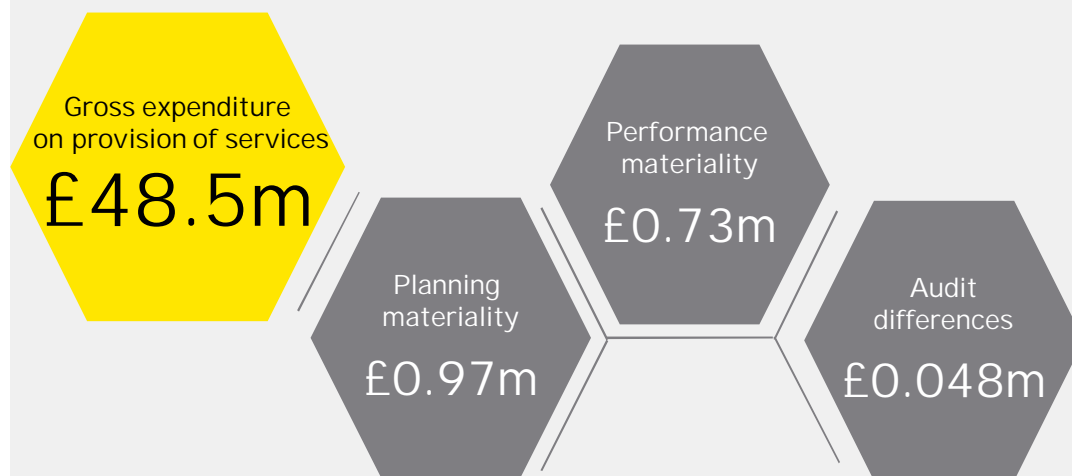
## Audit materiality



## Materiality

### Materiality

For planning purposes, materiality for 2019/20 has been set at £0.97m. 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 D.



We request that the Audit-Sub 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 £0.73m which represents 75% of planning materiality.

**Audit difference threshold** – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement and balance

**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-Sub Committee, or are important from a qualitative perspective.

**Specific materiality** – We have considered disclosures in the financial statements where misstatement at a lower level than our overall materiality level might influence the reader of the financial statements. For our strategy we have assessed the Remuneration disclosures including any severance payments, members allowances exit packages and termination benefits as numerically sensitive and set a materiality level of £1k, being the rounding number in the financial statements.



05

## Scope of our audit



## Our Audit Process and Strategy

### Objective and Scope of our Audit scoping

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 their use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

#### 1. Financial statement audit

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

We 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 on their 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, Audit-sub Committee and senior management.

Internal audit:

We will regularly meet with the Head of Internal Audit, and review internal audit plans and the results of their work. We do not plan to place reliance on the work of internal audit but will consider 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.



06

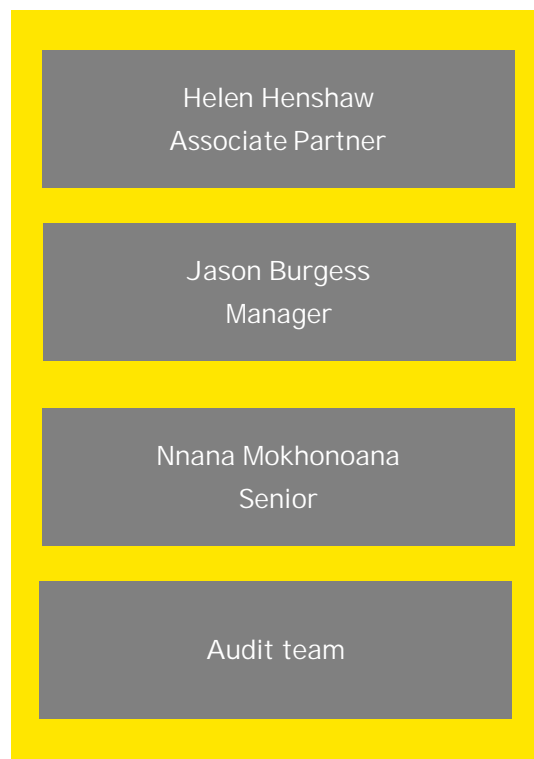
Audit team



## Audit team and use of specialists

### Audit team structure:

The engagement team is led by Helen Henshaw, Associate Partner, supported by Jason Burgess, Manager, who is responsible for the day-to-day direction of audit work and is the key point of contact for the finance team. Both work within our dedicated Government and Public Sector team and have significant experience on council audits.



### 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   |
|---------------------|---|
| Pensions disclosure | Actuaries of the Derbyshire Pension Fund, the Public Sector Audit Appointments (PSAA) consulting actuary and our EY actuarial service |

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





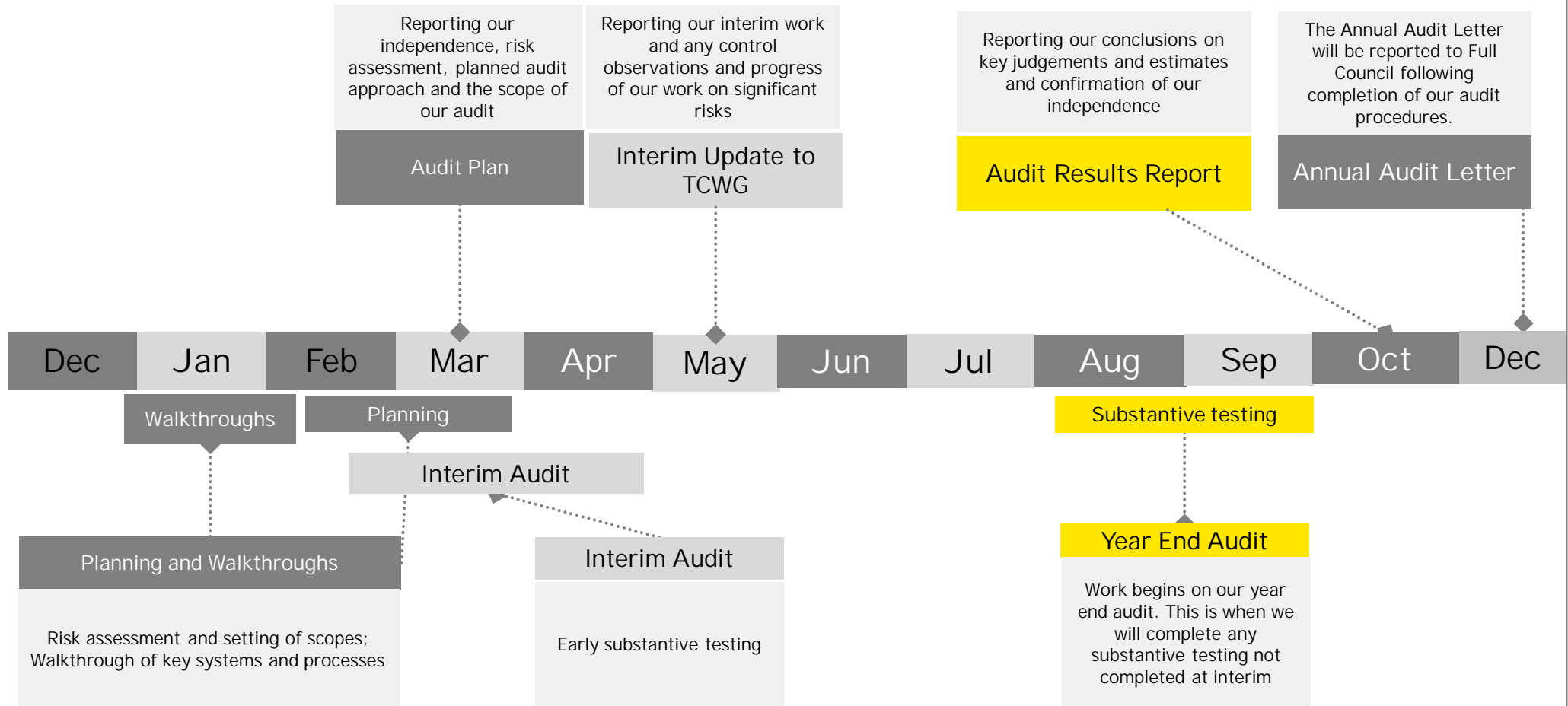
## Audit timeline

# 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 Council and we will discuss them and senior management as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.





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## 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   |
|--|---|
| <ul style="list-style-type: none"> <li>▶ The principal threats, if any, to objectivity and independence identified by Ernst &amp; Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;</li> <li>▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;</li> <li>▶ The overall assessment of threats and safeguards;</li> <li>▶ Information about the general policies and process within EY to maintain objectivity and independence.</li> <li>▶ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard [note: additional wording should be included in the communication reflecting the client specific situation]</li> </ul> | <ul style="list-style-type: none"> <li>▶ 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;</li> <li>▶ Details of non-audit services provided and the fees charged in relation thereto;</li> <li>▶ 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;</li> <li>▶ Written confirmation that all covered persons are independent;</li> <li>▶ 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;</li> <li>▶ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and</li> <li>▶ An opportunity to discuss auditor independence issues.</li> </ul> |

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 Helen Henshaw, 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.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

At the time of writing, there are no non-audit services to be provided.

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.

### 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.

# 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.

The table below sets out the self review threats that exist as the date of this report.

| Description of service   | Related independence threat   | Period provided/ duration  | Safeguards adopted and reasons considered to be effective  |
|--|---|--|--|
| <p>Housing benefit work no longer forms part of the work required by PSAA.</p> <p>For 2018/19 the planned fee was £15,500. The work has recently been completed and once the final fee has been agreed we will discuss with Strategic Director (Corporate Resources) the appointment for this work in 2019/20.</p> | Self review threat – figures included in the return are also accounted for in the financial statements. | Year ended 31 March 2019 and for all subsequent accounting periods. However, this will be assessed annually. | <p>The specific testing of individual benefit claims and associated subsidy calculations undertaken in respect of the Housing Benefits agreed upon procedures engagement is distinct and separate to any work we have or will undertake on the financial systems of the Council. The results of the testing is not reflected in the amounts included/disclosed in the financial statements.</p> <p>In respect of the checking of benefit system parameters, this work is common across our external audit procedures and this engagement.</p> <p>Our external audit of the financial statements is concluded prior to the Housing Benefit engagement. The financial statements audit conclusion is therefore not reliant upon the conclusion of the Housing Benefit engagement.</p> <p>No advice will be given in relation to accounting treatment.</p> <p>The report we provide will be prepared or given solely for the purposes of the agreed upon procedures engagement for Housing Benefits and will not be used or relied upon for any other purposes.</p> |

## 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. We anticipate that new requirements for other entities will follow and we will continue to monitor and assess the impact.

## 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 year end 30 June 2019:

[https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/\\$FILE/ey-uk-2019-transparency-report.pdf](https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/$FILE/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.

A breakdown of our fees is shown in the table below.

|   | Planned fee<br>2019/20 | Scale fee<br>2019/20 | Final Fee<br>2018/19 |
|---|------------------------|----------------------|----------------------|
|   | £                      | £                    | £                    |
| Total Fee – Code work   | (Note 4)               | 39,942               | 39,942               |
| Other   | (Note 4)               | N/A                  | 2,000<br>(Note 1)    |
| <b>Total audit</b>  | <b>TBC</b>             | <b>39,942</b>        | <b>41,942</b>        |
| Other non-audit services not covered above (Housing Benefits) | TBC                    | N/A                  | (Note 2)             |
| Pooling of housing capital receipts                           | TBC                    | N/A                  | (Note 3)             |
| <b>Total other non-audit services</b>                         | <b>TBC</b>             | <b>N/A</b>           | <b>TBC</b>           |
| <b>Total fees</b>   | <b>TBC</b>             | <b>33,240</b>        | <b>TBC</b>           |

All fees exclude VAT

(1) Scale fee variation of £2k relates to the additional pension procedures undertaken in relation to the impact of the McCloud judgement. This has been discussed and agreed with management but is still subject to approval by Public Sector Audit Appointments Limited.

(2) The Housing benefits work has recently been completed and we are currently determining the final fee with management.

(3) The fee for the pooling of housing capital receipts work cannot be confirmed as the work will not be completed until the end of March 2020.

(4) For 2019/20, the scale fee will be impacted by a range of factors (see pages 34 and 35). The specific issues we have identified at the planning stage which will impact on the fee include the additional work that will be required to address the value for money risk identified.

- In addition, we are driving greater innovation in the audit through the use of technology. The significant investment costs in this global technology continue to rise as we seek to provide enhanced assurance and insight in the audit.

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.

## Appendix A

### Fees

We do not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity. For an organisation such as the District Council the extent of audit procedures now required mean it will take around 900 hours to complete a quality audit. Based on our own modelling of the inputs required to complete an external audit of the Council concludes that a more appropriate scale fee for the delivery of an external audit to the Council would be in the region of £60,000.

#### 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.
  - To address this risk our procedures now entail higher samples sizes of transactions, the need to increase our use of analytics data to test more transactions at a greater level of depth. This requires a continual investment in our data analytics tools and audit technology to enhance audit quality. This also has an impact on local government with the need to also keep pace with technological advancement in data management and processing for audit.
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.
  - To address these findings, our required procedures now entail higher samples sizes, increased requirements for corroborative evidence to support the assumptions and use of our internal specialists.
3. Regulatory environment. Other pressures come from the changing regulatory landscape and audit market dynamics:
  - 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.
  - This means continual investment in our audit quality infrastructure in response to these regulatory reviews, the increasing fines for not meeting the requirements plus changes in auditing and accounting standards. As a firm our compliance costs have now doubled as a proportion of revenue in the last five years. The regulatory lens on Local Audit specifically, is greater. We are three times more likely to be reviewed by a quality regulator than other audits, again increasing our compliance costs of being within this market.

## Fees

### Summary of key factors (cont'd)

4. As a result 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.




### Next steps

- In light of recent communication from PSAA, we will need to quantify the impact of the above to be able to accurately re-assess what the baseline fee is for the Council should be in the current environment. Once this is done we will be able to discuss at a more detailed level with you.

## Appendix B




# Required communications with the Audit-sub Committee

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

|                                     |   |  Our Reporting to you                             |
|-------------------------------------|---|--|
| Required communications             |  What is reported?   |  When and where                                   |
| Terms of engagement                 | Confirmation by the Audit-sub 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.<br>When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team  | Audit planning report (March 2020)   |
| Significant findings from the audit | <ul style="list-style-type: none"> <li>• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>• Significant difficulties, if any, encountered during the audit</li> <li>• Significant matters, if any, arising from the audit that were discussed with management</li> <li>• Written representations that we are seeking</li> <li>• Expected modifications to the audit report</li> <li>• Other matters if any, significant to the oversight of the financial reporting process</li> </ul> | Audit results report (October 2020)  |



## Appendix B

# Required communications with the Audit-sub Committee (continued)

|                         |   |  Our Reporting to you |
|-------------------------|---|--|
| Required communications |  What is reported?   |  When and where       |
| Going concern           | <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>• Whether the events or conditions constitute a material uncertainty</li> <li>• Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>• The adequacy of related disclosures in the financial statements</li> </ul> | Audit results report (October 2020)  |
| Misstatements           | <ul style="list-style-type: none"> <li>• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>• The effect of uncorrected misstatements related to prior periods</li> <li>• A request that any uncorrected misstatement be corrected</li> <li>• Corrected misstatements that are significant</li> <li>• Material misstatements corrected by management</li> </ul>   | Audit results report (October 2020)  |
| Fraud                   | <ul style="list-style-type: none"> <li>• Enquiries of the Audit-sub Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>• Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>• A discussion of any other matters related to fraud</li> </ul>   | Audit results report (October 2020)  |
| Related parties         | <ul style="list-style-type: none"> <li>• Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</li> <li>• Non-disclosure by management</li> <li>• Inappropriate authorisation and approval of transactions</li> <li>• Disagreement over disclosures</li> <li>• Non-compliance with laws and regulations</li> <li>• Difficulty in identifying the party that ultimately controls the entity</li> </ul>              | Audit results report (October 2020)  |

## Appendix B

# Required communications with the Audit-sub Committee (continued)

|  |  | Our Reporting to you   |
|--|--|--|
| Required communications                    |  What is reported?  |  When and where |
| Independence                               | <p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>• The principal threats</li> <li>• Safeguards adopted and their effectiveness</li> <li>• An overall assessment of threats and safeguards</li> <li>• Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul> | Audit planning report (March 2020) and Audit results report (October 2020)                         |
| External confirmations                     | <ul style="list-style-type: none"> <li>• Management's refusal for us to request confirmations</li> <li>• Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>   | Audit results report (October 2020)  |
| Consideration of laws and regulations      | <ul style="list-style-type: none"> <li>• 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</li> <li>• Enquiry of the Audit-sub 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-sub Committee may be aware of</li> </ul>  | Audit results report (October 2020)  |
| Internal controls                          | <ul style="list-style-type: none"> <li>• Significant deficiencies in internal controls identified during the audit</li> </ul>  | Audit results report (October 2020)  |
| Representations                            | Written representations we are requesting from management and/or those charged with governance   | Audit results report (October 2020)  |
| Material inconsistencies and misstatements | Material inconsistencies or misstatements of fact identified in other information which management has refused to revise   | Audit results report (October 2020)  |
| Auditors report                            | <ul style="list-style-type: none"> <li>• Key audit matters that we will include in our auditor's report</li> <li>• Any circumstances identified that affect the form and content of our auditor's report</li> </ul>  | Audit results report (October 2020)  |
| Fee Reporting                              | <ul style="list-style-type: none"> <li>• Breakdown of fee information when the audit plan is agreed</li> <li>• Breakdown of fee information at the completion of the audit</li> <li>• Any non-audit work</li> </ul>  | Audit planning report (March 2020) and Audit results report (October 2020)                         |

## 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 system of 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 activities within the Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the Audit-sub Committee reporting appropriately addresses matters communicated by us to the Audit-sub Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- Maintaining auditor independence.

### 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 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.