South Derbyshire District Council

Audit planning report

Year ended 31 March 2021

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11 June 2021

South Derbyshire District Council
Civic Offices
Civic Way
Swadlincote
DE11 0AH

Dear Audit Sub-Committee Members

Audit planning report 2020/21

We are pleased to attach our Preliminary 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 2020/21 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2020 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 with the Committee's service 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 management, and is not intended to be and should not be used by anyone other than these specified parties.

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

Yours faithfully

Helen Henshaw

For and on behalf of Ernst & Young LLP

Contents

Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit 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 Sub-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 2020/21 audit strategy

Overview of our 2020/21 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	Change in focus from 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 10 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 11.
Valuation of property, plant and equipment (PPE) – land and buildings	Significant risk	No change in risk or focus from the prior year	Land and buildings assets account for a significant proportion of the Council's assets. 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 12.
Local Government Pension scheme (LGPS)	Inherent risk	Area of focus in the prior year	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. The Council is a members of the LGPS, administered by Derbyshire Pension Fund. 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 13.

Overview of our 2020/21 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
Going concern compliance with ISA570	Area of audit focus	Significant risk in the prior year	ISA570, Going Concern, has been revised by the International Auditing and Assurance Standards Board 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 the audit of the 2020/21 financial statements, and increases the work we are required to perform when assessing whether the Council is a going concern. It imposes significantly stronger requirements on auditors and audited bodies than those required by current international standards; and we have therefore judged it appropriate to bring this to the attention of the Audit Committee. We will discuss the detailed implications of the new standard with finance staff. Further details are set out on page 14.
IFRS 16 – accounting for leases	Other financial statement risk	Change in risk or focus from the prior year	The implementation of this accounting standard was identified as an area of audit focus in the 2019/20 Audit Plan as it was due to be implemented on 1 April 2020. However due to pressures on council finance teams as a result of the COVID-19 pandemic the CIPFA LASAAC Local Authority Accounting Code Board has agreed to defer the implementation date to 1 April 2022. This deferral is limited to one year only and no further extensions will be made based on lack of preparedness. Further details of the risk are provided at page 15.

Overview of our 2020/21 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 2021 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.

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, as well as the expansion of factors impacting the value for money conclusion. Therefore to the extent any of these or any other risks are relevant in the context of South Derbyshire District Council's audit, we will discuss these with management as to the impact on the scale fee. Further details are provided at pages 36 and 37.

Overview of our 2020/21 audit strategy

Value for money conclusion (VFM)

One of the main changes in the NAO's 2020 Code of Audit Practice is in relation to the value of money conclusion. We include full details in section 3 but in summary:

- We are still required to consider whether the Council has put in place 'proper arrangements' to secure the economy, efficiency and effectiveness on its use of resources
- Planning on VFM and the associated risk assessment is now focused on gathering sufficient evidence to enable us to document our evaluation of the Council's arrangements, to enable us to draft commentary under the three reporting criteria detailed below. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations.
- We will be required to provide a commentary on the arrangements of the Council against the following reporting criteria;
    - Financial sustainability – how the Council plans to manage its resources to ensure it can continue to deliver its services;
    - Governance – how the Council ensures that it makes informed decisions and properly manages its strategic risks; and
    - Improving economy, efficiency and effectiveness – how the Council uses information about its costs and performance to improve the management and delivery of services to the public.
- Within the audit opinions we still only report by exception where we are not satisfied that the Council has proper arrangements in place for securing the economy, efficiency and effectiveness in its use of resources.
- The commentary on arrangements will be included in a new Auditor's Annual Report which can be issued after the audit opinions for the financial statements are reported.

Materiality

Planning materiality
£982k

Planning materiality has provisionally been set at £982k (£970k 2019/20), which represents 2% of the prior years gross expenditure on provision of services per the draft financial statements.

Performance materiality
£736k

Performance materiality has been set at £736k, which represents 75% of materiality (consistent with the prior year).

Audit differences
£49k

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement) greater than £49k. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Sub-Committee. See section 4 for further details.

02 Audit risks

Our response to significant risks

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

Risk of fraud in revenue and expenditure recognition*

Financial statements impact

Misstatements that occur in relation to the risk of fraud in both revenue and expenditure that could affect the comprehensive income and expenditure statement.

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.

Taking into account the results of the 2019/20 audit we consider the risk manifests itself in the following areas:

- Recognition of income and expenditure in relation to new covid-19 related grants received in the year;
- 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; and
- Inappropriate capitalisation of revenue expenditure which could result in a misstatement of the cost of services reported in the comprehensive income and expenditure statement.

Our audit approach

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

- Review the appropriateness of the Council's accounting policies for grant income recognition and the processes in place for the consistent application of those accounting policies;
- For a sample, responsive to our risk assessment, of grants received by the Council in the year, review the conditions attaching to the grant and ensure that the income (and associated expenditure) has been appropriately recognised in accordance with the accounting framework;
- 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 statements, specifically to;
    i. the accounting entries for pass through grants; and
    ii. 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 confirm recognition is in accordance with accounting policies and standard IAS 16.

Our response to significant risks (continued)

Misstatements due to fraud or error*

Financial statements impact

Misstatements that occur in relation to the risk of fraud or error could affect both the Comprehensive income and expenditure statement and the balance sheet. We deem the risk most prevalent when reviewing journals involved in the financial statements close process.

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.

Our audit approach

We will:

- Identify fraud risks during the planning stages;
- Make inquiries of management about risks of fraud and the controls put in place to address those risks;
- Understand the oversight given by those charged with governance of management's processes over fraud;
- Consider the effectiveness of management's controls designed to address the risk of fraud;
- Determine an appropriate strategy to address those identified risks of fraud;
- Perform mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements; and
- Review and discuss with management any changes the methodologies of existing and new accounting estimates, which include accruals and provisions, for evidence of bias;
- Undertake risk based testing of journals from the accounting period that are identified from the application of specified audit risk criteria; and
- Consider and evaluate the existence and nature and business rationale of significant unusual transactions;

Our response to significant risks (continued)

Valuation of land and buildings

Financial statements impact

As the Council's asset base is material, and the outputs from the valuer are subject to estimation, there is a risk land and building assets statement in the balance sheet may be under or overstated.

What is the risk?

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.

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.

The Council has a rolling valuation process, which means that assets are revalued at a minimum every 5 years. The process is subject to a number of assumptions and judgements, which if inappropriate could result in a material impact on the financial statements. There is also a potential that the assets not formally revalued in year may have experienced a material change in value which has not been identified and accounted for appropriately.

Our audit approach

We will:

- 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;
- Evaluate the competence, capabilities and objectivity of management's specialist;
- Review any 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;
- Engage our valuation specialists to support our testing strategy and help evaluate the work of the Council's valuer specifically to assess if the movement on the unvalued population has been addressed appropriately;
- Engage our valuation specialists to support our testing strategy and help evaluate the work of the Council's valuer;
- Perform appropriate tests over the completeness and appropriateness of information provided to the valuer;
- Review the classification of assets and ensure the correct valuation methodology has been applied;
- Ensure the valuer's conclusions have been appropriately recorded in the financial statements; and
- Review assets not subject to formal revaluation in 2020/21, to confirm that the remaining asset base is not materially misstated.

Our response to inherent risks

Pension Valuation Liability – LGPS

Financial statements impact

As the outputs are from the actuary there is a risk that the IAS 19 information is omitted or incorrectly disclosed in the financial statements.

What is the risk?

The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by South Derbyshire District Council.

The Council's pension fund deficit is a material estimated balance and the Code requires that the net liability be disclosed on the Council's balance sheet.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Pension Fund. Accounting for this scheme 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.

Our audit approach

We will

- Perform appropriate tests to obtain assurance over the information provided to the actuary;
- Write to the Pension Fund auditor requesting a program of work be conducted in respect of South Derbyshire District Council's share of the total fund and to ascertain whether there are material concerns we need to be aware of for our audit;
- Ensure accounting entries and disclosures are consistent with the actuaries report; and
- Assess the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team.

Other areas of audit focus

What is the risk/area of focus?	Our audit approach
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 South Derbyshire District 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 South Derbyshire District 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 Sub-Committee. In order to perform our work under the revised ISA, we will require a robust assessment from management of the financial position and going concern basis of the Authority, which clearly sets out and evidences the key risks, mitigations and assumptions that underpin that assessment.	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 Authority 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. • 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.

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
IFRS 16 – Accounting for leases IFRS 16 accounting for leased 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 tear the are paid. IFRS 16 requires all substantial leases to be accounted for using the acquisition approach, recognising the rights acquired to use an asset. The CIPFA LASAAC Local Authority Accounting Code Board has agreed to defer the implementation of IFRS 16 Leases in the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) until the 2022/23 financial year. This aligns with the decision at the Government's Financial Reporting Advisory Board to establish a new effective date of 1 April 2022 for the implementation of IFRS 16.	Although the new standard will not be included until CIPFA Code of Practice until 2022/23, work will be necessary to secure information required to enable Local Government bodies to fully assess their leasing position and ensure compliance with the standard from 1 April 2022. In particular, full compliance with the revised standard is likely to require a detailed review of existing lease and other contract documentation prior to 1 April 2022 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 2022 where a lease has previously been accounted for as an operating lease. We will discuss with management what progress has been made for the implementation of IFRS 16.

03 Value for Money Risks

Value for money

Council responsibilities for value for money

The Council is required to maintain an effective system of internal control that supports the achievement of its policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

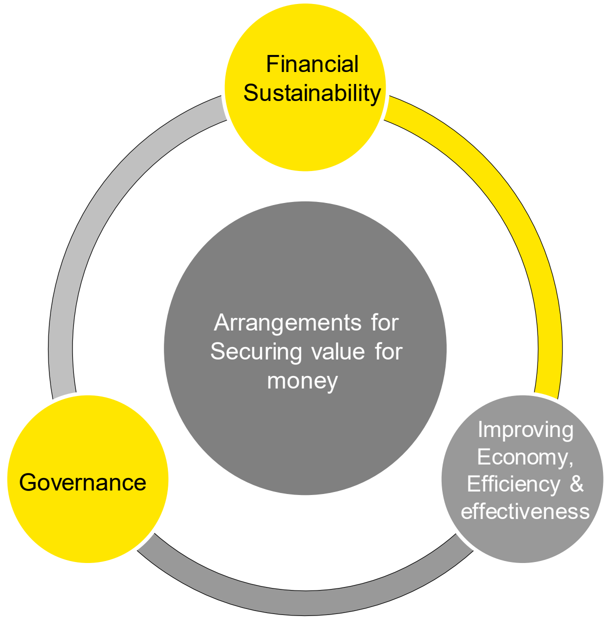
As part of the material published with its financial statements, the Council is required to bring together commentary on its governance framework and how this has operated during the period in a governance statement. In preparing its governance statement, the Council tailor's the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on its arrangements for securing value for money from their use of resources.

Auditor responsibilities under the new Code

Under the 2020 Code we are still required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. However, there is no longer overall evaluation criterion which we need to conclude on. Instead the 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Council a commentary against specified reporting criteria (see below) on the arrangements the Council has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

- Financial sustainability
  How the Council plans and manages its resources to ensure it can continue to deliver its services;
- Governance
  How the Council ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness:
  How the Council uses information about its costs and performance to improve the way it manages and delivers its services.



Value for money risks

Planning and identifying VFM risks

The NAO's guidance notes require us to carry out a risk assessment which gathers sufficient evidence to enable us to document our evaluation of the Council's arrangements, in order to enable us to draft a commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations. This is a change to 2015 Code guidance notes where the NAO required auditors as part of planning, to consider the risk of reaching an incorrect conclusion in relation to the overall criterion.

In considering the Council's arrangements, we are required to consider:

- The Council's governance statement
- Evidence that the Council's arrangements were in place during the reporting period;
- Evidence obtained from our work on the accounts;
- The work of inspectorates (such as CQC) and other bodies and
- Any other evidence source that we regard as necessary to facilitate the performance of our statutory duties.

We then consider whether there is evidence to suggest that there are significant weaknesses in arrangements. The NAO's guidance is clear that the assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement. However, the NAO states that a weakness may be said to be significant if it:

- Exposes – or could reasonably be expected to expose – the Council to significant financial loss or risk;
- Leads to – or could reasonably be expected to lead to – significant impact on the quality or effectiveness of service or on the Council's reputation;
- Leads to – or could reasonably be expected to lead to – unlawful actions; or
- Identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

We should also be informed by a consideration of:

- The magnitude of the issue in relation to the size of the Council;
- Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves (where applicable), or impact on budgets or cashflow forecasts;
- The impact of the weakness on the Council's reported performance;
- Whether the issue has been identified by the Council's own internal arrangements and what corrective action has been taken or planned;
- Whether any legal judgements have been made including judicial review;
- Whether there has been any intervention by a regulator or Secretary of State;
- Whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- The impact on delivery of services to local taxpayers; and
- The length of time the Council has had to respond to the issue.

Value for money risks

Responding to identified risks

Where our planning work has identified a risk of significant weakness, the NAO's guidance requires us to consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including where appropriate, challenge of management's assumptions. We are required to report our planned procedures to the audit committee.

Reporting on VFM

In addition to the commentary on arrangements, where we are not satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources the 2020 Code has the same requirement as the 2015 Code in that we should refer to this by exception in the audit report on the financial statements.

However, a new requirement under the 2020 Code is for us to include the commentary on arrangements in a new Auditor's Annual Report. The 2020 Code states that the commentary should be clear, readily understandable and highlight any issues we wish to draw to the Council's attention or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with our view as to whether they have been implemented satisfactorily.

Status of our 2020/21 VFM planning

We have yet to commence our detailed VFM planning. However, one area of focus will be on the arrangements that the Council has in place in relation to financial sustainability in light of the impact of Covid-19 on local government financing.

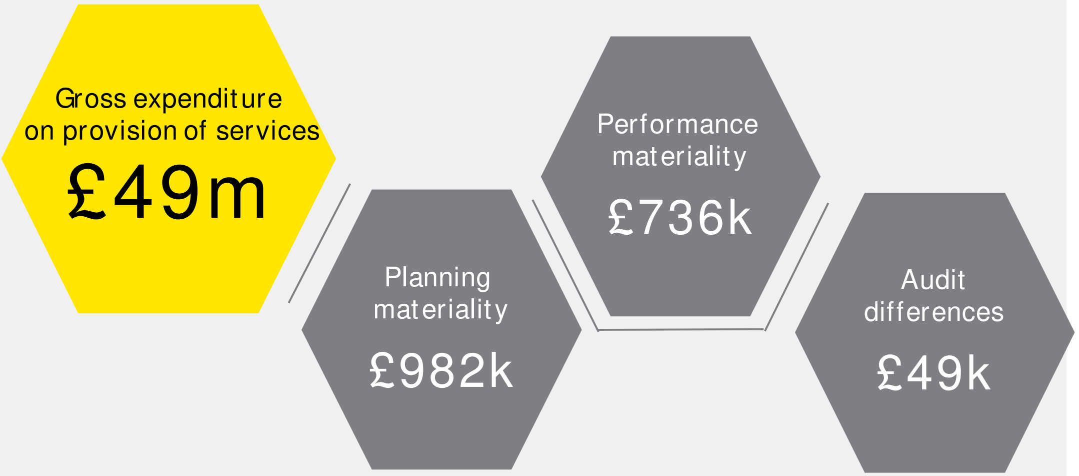
We will update the next Committee meeting on the outcome of our VFM planning and our planned response to any identified risks of significant weaknesses in arrangements.

04 Audit materiality

Materiality

Materiality

For planning purposes, planning materiality for 2020/21 has been provisionally set at £982k. This represents 2% of the Council's prior year gross expenditure on provision of services per the prior year financial statements. This basis is consistent with the prior year. 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 £736k which represents 75% of planning materiality.

We have set performance materiality at 75% to reflect the low level of errors (corrected and uncorrected) experienced in prior year audits of South Derbyshire District Council and therefore our anticipation of error in the current year.

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 sheet.

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 and Standards committee, or are important from a qualitative perspective.

Specific materiality – We have also identified the following areas where misstatement at a lower level than our overall materiality level might influence the reader of the financial statements. The areas identified in our audit strategy applied include: Related

- We assess the Senior officer remuneration disclosures including any severance payments, exit packages and termination benefits as numerically sensitive and set a materiality level of £1k, being the rounding number in the financial statements.
- Related party transactions. For any errors identified in related parties we considered the concept of the materiality of transactions and balances as would relevant to the related individual or organisation.
- Members' allowances; a figure of £1k is judged appropriate.

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

We issue an audit report that covers:

1. Financial statement audit

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

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

Procedures required by standards

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

Procedures required by the Code

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

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

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

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

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

For 2020/21 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics:

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

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

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

Internal audit:

We will regularly meet with the Head of Internal Audit and Chief Internal Auditor, and review internal audit plans and the results of their work. We will only use the internal audit reports to assist our audit planning processes.

06 Audit team

Use of specialists

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

Area	Specialists
Valuation of Land and Buildings	EY Property Valuations Team. Management specialists – District Valuer (external valuer) and Property services (internal valuer).
Pensions disclosure	PSAA consulting actuary, the actuary of the Derbyshire Pension Fund and EY Pension Team.

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

Timetable of communication and deliverables

Timeline

Below is an indicative timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2020/21.

We will continue to assess the appropriateness of this timetable through regular discussions with Council staff. Given the significant backlog of 2019/20

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

Audit phase	Proposed Timetable (2021)	Deliverables	Audit Sub-Committee timetable
Initial Planning: High level initial planning considerations	**April**		
Planning: Risk assessment and setting of scopes. Walkthrough of key systems and processes	**June**	Audit Planning Report	28 June 2021
Year end audit including WGA Audit Completion procedures	**August, November**	Audit Results Report (ISA 260)	TBC – post 30 November 2021.
Auditor's Annual Report	**TBC**	Annual Audit Results Report Audit opinions and completion certificates	TBC

08 Independence

Introduction

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

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

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

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

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

Relationships, services and related threats and safeguards

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

Overall Assessment

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

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees. 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.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%

At the time of writing, the current ratio of non-audit fees to audit fees is NIL No additional safeguards are required.

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

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

Self review threats

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

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

Management threats

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

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

Other threats

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

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

New UK Independence Standards

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

Summary of key changes

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

Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under FRC Revised Ethical Standard 2016 which will continue to apply until 31 March 2021 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 1 April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.
We do not provide any non-audit services which would be prohibited under the new standard.

Other communications

EY Transparency Report 2020

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 2020:
https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2020/ey-uk-2020-transparency-report.pdf

09 Appendices

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.

The Scale Fee for South Derbyshire District Council is set at £37,942.

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 South Derbyshire District Council the extent of audit procedures now required mean it will take around 1,300 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 £62,500. This does not include any potential impact of covid-19 on the audit process for 2020/21. This revised fee is not accepted by management at this stage.

Summary of key factors impacting inappropriateness of the existing scale fee

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.

Fees (continued)

Summary of key factors impacting inappropriateness of the existing scale fee (continued)

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, with the potential for increased financial penalties should audit firms fail to meet the increased regulatory requirements.

   - This means continual investment in our audit quality infrastructure in response to these regulatory reviews and to 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.

4. **Resource Availability**

   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 to enable us to provide the highest performing audit teams, maintain the high standard of client service which you would expect and protect audit quality.

Next steps

- In light of recent communications from PSAA, and the recent consultation in respect of scale fee setting, we will undertake detailed discussions with management in respect of the audit delivery model and associated fee and report back to you at a later date.

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. 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
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Audit results report

Required communications with the Audit Sub-Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	Audit results report
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	Audit results report
Fraud	• Enquiries of the Audit Sub-Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud	Audit results report
Related parties	• Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	Audit results report

Appendix B

Required communications with the Audit Sub-Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2016: • Relationships between EY, the Council and senior management, its affiliates and its connected parties • Services provided by EY that may reasonably bear on the auditors' objectivity and independence • Related safeguards • Fees charged by EY analysed into appropriate categories such as statutory audit fees, tax advisory fees, other non-audit service fees • A statement of compliance with the Ethical Standard, including any non-EY firms or external experts used in the audit • Details of any inconsistencies between the Ethical Standard and Group's policy for the provision of non-audit services, and any apparent breach of that policy • Details of any contingent fee arrangements for non-audit services • Where EY has determined it is appropriate to apply more restrictive rules than permitted under the Ethical Standard • The Audit Sub-Committee should also be provided an opportunity to discuss matters affecting auditor independence	Audit planning report and Audit results report

Appendix B

Required communications with the Audit Sub-Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report
Consideration of laws and regulations	• Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Audit 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	Audit results report
Internal controls	• Significant deficiencies in internal controls identified during the audit	Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	• Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Audit planning report and Audit results report

Appendix C

Additional audit information

Other required procedures during the course of the audit

In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

Our responsibilities required by auditing standards	• Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. • Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. • Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. • Concluding on the appropriateness of management's use of the going concern basis of accounting. • Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. • Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, the Audit 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 locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

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