South Derbyshire District Council

Annual Audit Letter for the year ended 31 March 2018

July 2018

Building a better working world

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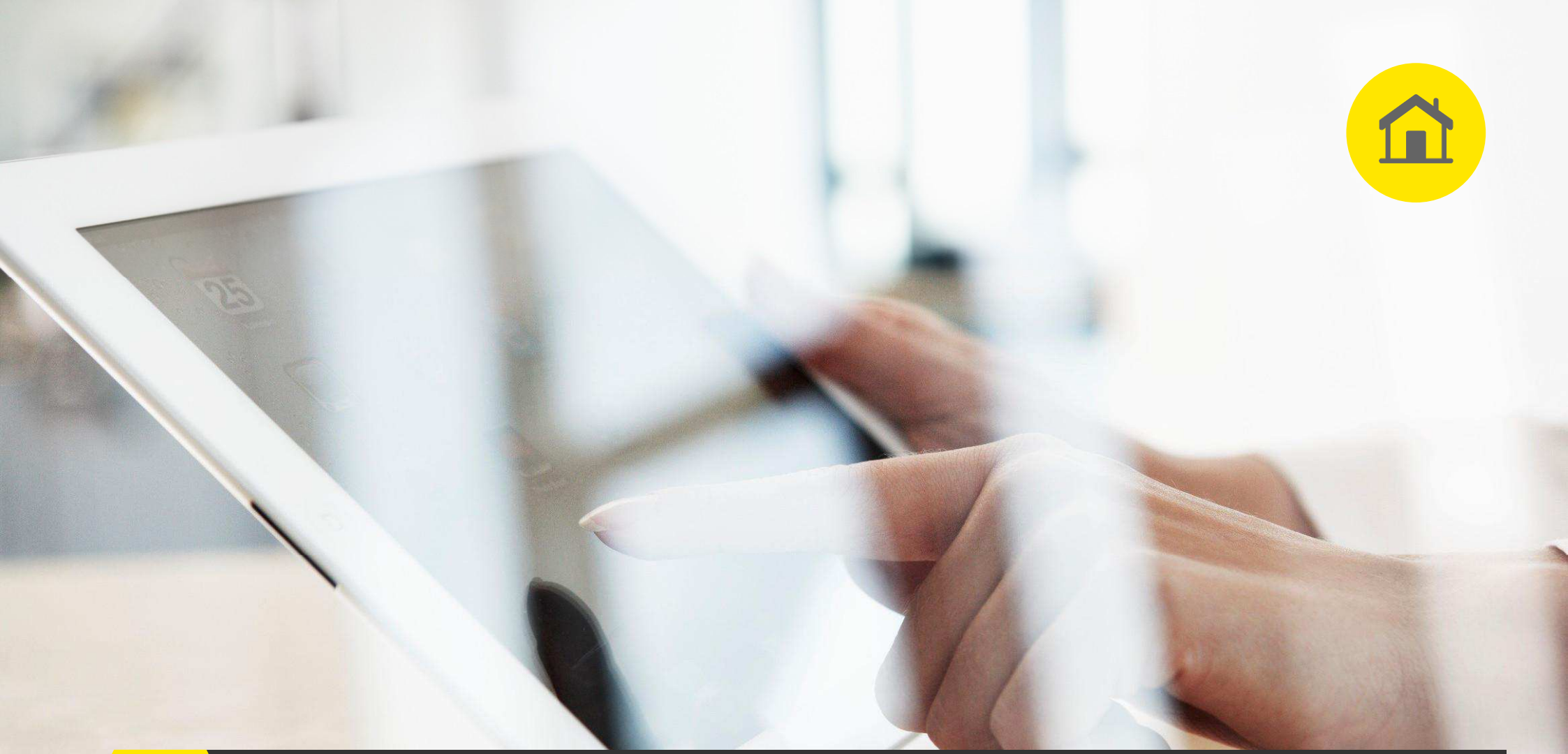
Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment (updated 23 February 2017)' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.



01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to South Derbyshire District Council (the Council) following completion of our audit procedures for the year ended 31 March 2018.
Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have not put in place proper arrangements to secure value for money in your use of resources Further details relating to value for money work are detailed at page 15

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

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 19 July 2018
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 31 July 2018.

Later in the year we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

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

Stephen Clark

Partner

For and on behalf of Ernst & Young LLP

02 Purpose

Purpose

The Purpose of this Letter

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

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the 19 July 2018 Audit-Sub Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

03 Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued on 21 March 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2017/18 financial statements, and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

Responsibilities of the Council

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

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

04 Financial Statement Audit

Financial Statement Audit

Key Issues

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

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2018.

Our detailed findings were reported to the 25 July Audit-Sub Committee.

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

Significant Risk	Conclusion
Misstatements due to fraud or error As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement. We consider the risk most focussed around items of expenditure that are non-routine and involve management's judgement and estimation to determine items such as year-end accruals and provisions. We also consider the risk to manifest in the potential to inappropriately capitalise revenue spend.	• We documented 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; • We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; • We reviewed the calculation of management's accruals, estimates and provisions for evidence of management bias; • We evaluated the business rationale for significant unusual transactions; • We documented the oversight given by those charged with governance of management process over fraud; • We sample tested accruals and provisions based on established testing thresholds; • We reviewed capital expenditure on property plant and equipment to ensure it meets the relevant accounting requirements to be capitalised; and • We reviewed the accounting adjustments processed in the movement in reserves to ensure consistency with other supporting disclosure notes. We have not identified any material weaknesses in controls or evidence of material management override. We have not identified any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
Risk of fraud in revenue and expenditure recognition 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. Due to the nature and value of income which comprises of Government Grants, income from council tax, business rates, housing rents and fees and charges, our view is that the risk is not significant in this area, but is relevant to the completeness of other income (sales, fees and charges) and other operating expenditure.	Income from sales, fees and charges: To gain assurance over the occurrence and measurement of other income we obtained a schedule of other income included within the Comprehensive Income and Expenditure statement. We then substantively tested items of income on a sample basis. Other operating expenditure: The risk is around the completeness of operating costs in the 17-18 financial year. We performed cut-off testing on the balance sheet side which we extended out to the end of June 2018 (3 months after the balance sheet date). We concluded that the financial statements are free from material misstatement with respect to the recognition of income and expenditure.

Other Risk	Conclusion
Valuation of Land and Buildings	The fair value of Property, Plant and Equipment (PPE) represent significant balances in the financial statements and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. • We tested the revaluation cycle, including instructions and completeness of information provided to the Council's external valuer; • We reviewed the classification of assets and assess how the Council has determined that the correct valuation methodology has been applied by the expert; and • We considered the approach adopted by the external valuer and their findings We concluded that the financial statements are free from material misstatement with respect to valuation of land and buildings.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Key Findings	Conclusion
Pension liability valuation	The Pension Scheme Actuary calculates the value of the Council's share of the total scheme to be included in the financial statements. In performing our audit procedures on the notified balances we observed that there was a large difference between the asset value of the total fund which the Actuary had used in their calculations, and the asset value of the fund as disclosed in the Derbyshire County Council Pension Scheme draft financial statements as at 31 March 2018. We have included this judgemental estimation difference in our summary of misstatements. However, the misstatement does not impact cash nor the outturn for the year.
Earlier deadline for the production of the financial statements	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. The timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July. These changes provide risks for both the preparers and the auditors of the financial statements. The Council now has less time to prepare the financial statements and supporting working papers. As your auditor, we have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within same compressed timetable. Slippage at one client could potentially put delivery of others at risk. We can confirm that the draft financial statements including the Annual Governance Statement were prepared by the 31 May 2018. The Council also submitted the general ledger and payroll data to our data analytics team in accordance with the agreed timetable. The 2017/18 audit has identified a higher number of errors compared to the previous year. It is our view that these are related to the earlier deadline. We recommend that the close down plan for 2018/19 is reviewed to make improvements to ensure that errors in the accounts are minimised.

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

Financial Statement Audit (cont'd)

Our application of materiality

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

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £0.94mn (2016/17: £0.92mn), which is 2%of actual year-end gross revenue expenditure. We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit-Sub Committee that we would report to the Committee all audit differences in excess of £0.047mn (2017/18: £0.046mn)

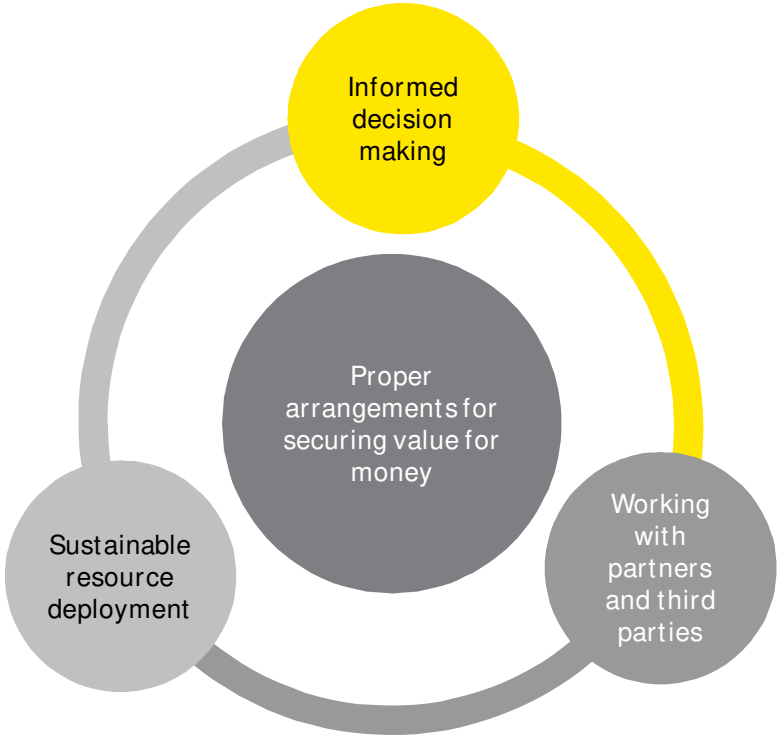
05 Value for Money

Value for Money

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.

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.



We identified two significant risks around these arrangements. The tables below present our findings in response to the risks in our Audit Planning report and any other significant weaknesses or issues we want to bring to your attention.

We have performed the procedures outlined in our audit plan. We identified the following significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. Please see the following page.

Value for Money (cont'd)

We issued a qualified value for money conclusion in relation to Councils arrangements to secure economy, efficiency and effectiveness in your use of resources on 31 July 2018.

Significant Risk	Conclusion
Securing financial resilience From the medium term financial plan, updated in January 2018, the Council has identified it will experience budget deficits from 2018/19 to 2022/23 with the general fund depleting from £9.1m to £2.7m but remaining above the £1m minimum level. Going forward the Council will need to continue to scrutinise its financial plans to achieve budget savings of £1m in 2019/20.	We have performed the following procedures: ▪ Reviewing the MTFS including the adequacy of major assumptions ▪ Reviewing the Council's arrangements to develop a robust savings plan to address the future financial challenges. Based on results of our procedures we are satisfied that appropriate arrangements are in place to manage this significant risk. Further analysis is provided over the page.
Procurement and related contract issues in the Housing and Environment Services Directorate In our 2016/17 Audit Results Report, we reported that the value for money conclusion was qualified on the basis the Housing and Environment Services Directorate had control weaknesses in its procurement and contract management arrangements which included having significant service contracts unsigned. As the Council started to implement recommendations part way through 2017/18, we have determined that the risk in this area remains relevant for the financial year.	We have performed the following procedures ▪ Reviewing the outcomes of the work undertaken by Internal Audit to establish if the recommendations have been fully implemented by management ▪ Understanding, if there are any incomplete recommendations, the extent of and impact they have on system of internal control and managements plans to address them ▪ Review the adequacy of managements governance arrangements to move to a shared procurement service. Our work has revealed that the Council has made a great deal of progress during 2017/18, but not all of the recommendations have been implemented and those that have are yet to be fully embedded.

06 Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. The Council is below the specified audit threshold of £500mn. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement

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

Report in the Public Interest

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

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

Written Recommendations

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

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

Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Reporting Issues (cont'd)

Other Powers and Duties

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

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit-Sub Committee on 25 July 2018. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

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

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

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

During the course of the audit we have identified a number of audit issues which we require to bring to your attention:

1. Rounding differences

   Our casting of the draft financial statements identified 29 rounding differences ranging between £1k and £3k. This is a high number of errors which need to be addressed in 2018/19.

2. Journal entries without descriptions

   In 2016/17 we reported to you that there thirteen journals where the journal description field was blank. We recommended that all journal entries contain a valid description. However, our interim testing of journals covering periods 1 to 9 in 2017/18 also identified that thirteen journals that did not contain a description. We noted that there was a compensating control which is to complete the journal log, maintained by the finance team which is reviewed by the financial services manager. We have confirmed that the log included the thirteen journal which showed that there was adequate detail to enable the journal to be authorised.

3. Accounts payable control account reconciliation

   Our review of the year-end control account reconciliation identified that there a number of reconciling items. This has been caused by posting rounded amounts into general ledger rather than the absolute value.

4. Processing of supplier invoices

   Our testing of operating expenditure identified two invoices totalling £250 were received on 7 March 2017 but were posted to the accounts payable system in early April 2017. The costs were recognised in the wrong financial year. We recommend that all supplier invoices are recorded on a timely basis to ensure the expenditure is recognised in the correct financial year.

07 Data Analytics

Use of Data Analytics in the Audit

[Data analytics —Area of the Financial Statements e.g., revenue recognition]

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the Council's audit included testing journal entries and employee expenses, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis

We obtain downloads of all financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.

Payroll Analysis

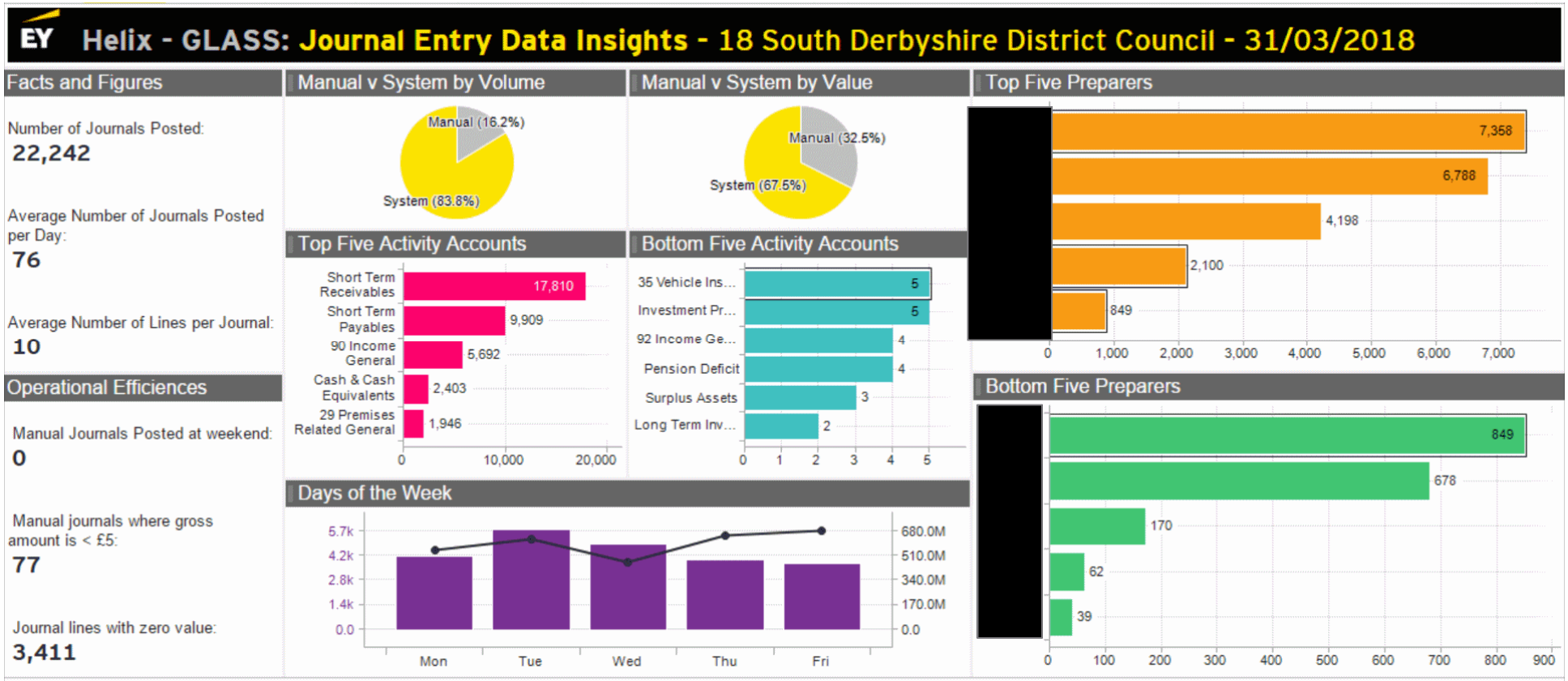
We also use our analysers in our payroll testing. We obtain all payroll transactions posted in the year from the payroll system and perform completeness analysis over the data, including reconciling the total amount to the General Ledger trial balance. We then analyse the data against a number of specifically designed procedures. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation.

Data Analytics

Journal Entry Data Insights

The graphic outlined below summarises the Council's journal population for 2017/18. We review journals by certain risk based criteria to focus on higher risk transactions, such as journals posted manually by management, those posted around the year-end, those with unusual debit and credit relationships, and those posted by individuals we would not expect to be entering transactions.

The purpose of this approach is to provide a more effective, risk focused approach to auditing journal entries, minimising the burden of compliance on management by minimising randomly selected samples.



Data Analytics (cont'd)

Journal Entry Testing

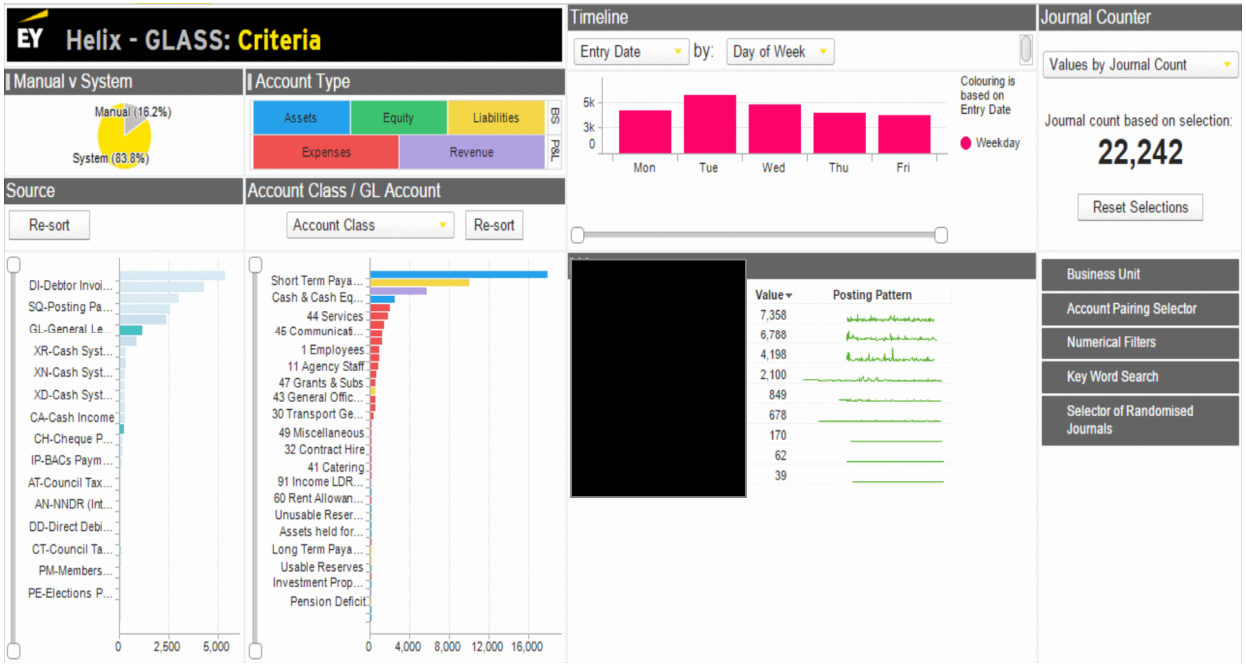
What is the risk?

In line with ISA 240 we are required to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

What judgements are we focused on?

Using our analysers we are able to take a risk based approach to identify journals with a higher risk of management override, as outlined in our audit planning report.

Journal entry data criteria —31 March 2018



What did we do?

We obtained general ledger journal data for the period and have used our analysers to identify characteristics typically associated with inappropriate journal entries or adjustments, and journals entries that are subject to a higher risk of management override.

We then performed tests on the journals identified to determine if they were appropriate and reasonable.

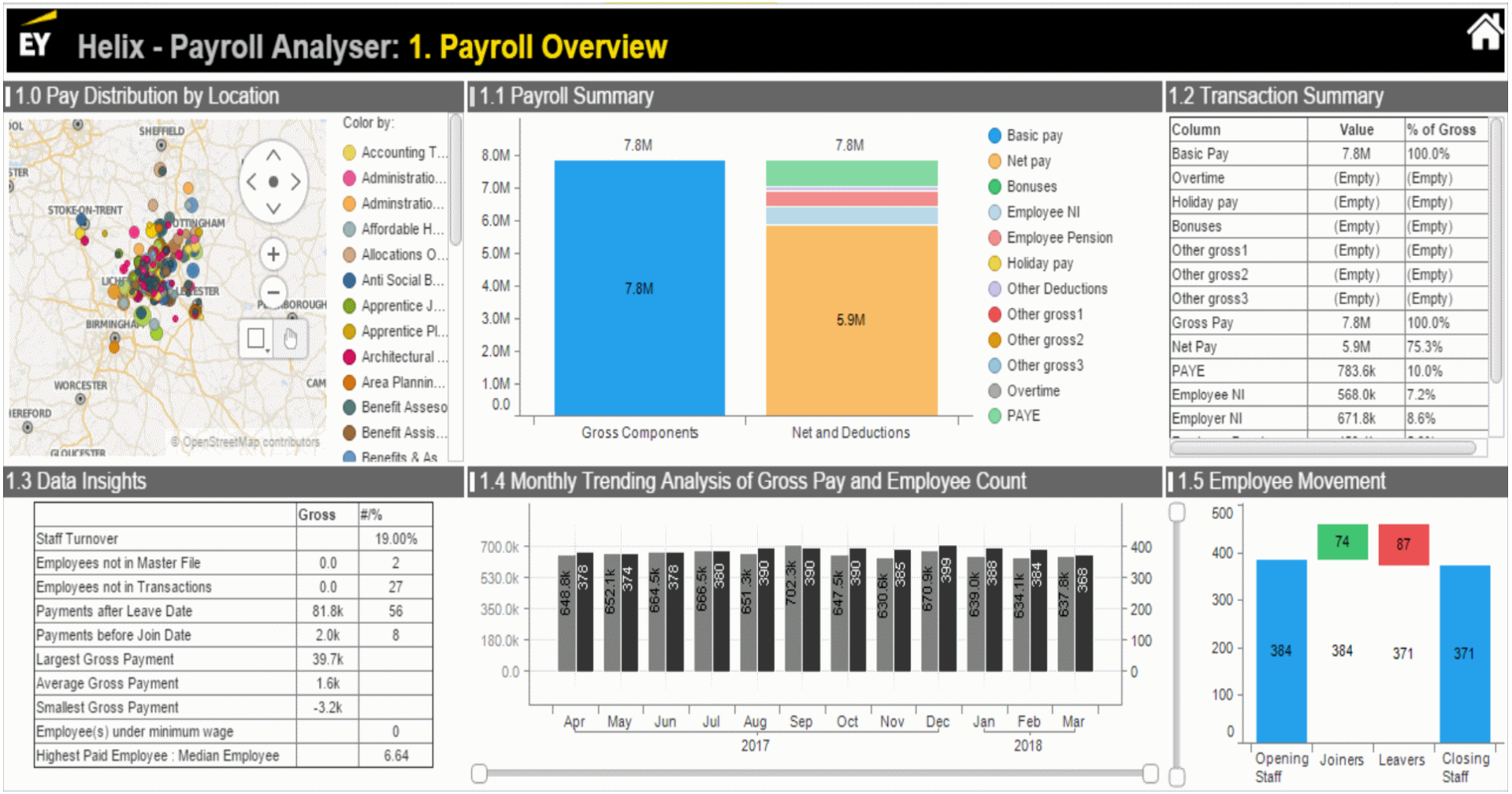
What are our conclusions?

We isolated a sub set of journals for further investigation and obtained supporting evidence to verify the posting of these transactions and concluded that they were appropriately stated.

Data Analytics (cont'd)

Payroll Analyser Insights

The graphic outlined below summarises the Council's payroll data for 2017/18. We review transactions for payroll at a more granular level, which allows us to identify items with a higher likelihood of containing material misstatements or to identify unusual patterns within a population of data and to design tests of details.



08 Focused on your future

Focused on your future

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

Standard	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: • How financial assets are classified and measured; • How the impairment of financial assets are calculated; and • The disclosure requirements for financial assets. There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.	Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to: • Reclassify existing financial instrument assets • Re-measure and recalculate potential impairments of those assets; and • Prepare additional disclosure notes for material items.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: • Leases; • Financial instruments; • Insurance contracts; and • For local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.	As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited. The standard is far more likely to impact on Local Authority Trading Companies who will have material revenue streams arising from contracts with customers. The Council will need to consider the impact of this on their own group accounts when that trading company is consolidated.

Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.

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