



North Tyneside Council

Audit Planning Report
Year ending 31 March 2020

March 2020

Private and Confidential
Audit Committee
North Tyneside Council
Quadrant
The Silverlink North
Cobalt Business Park
North Tyneside
NE27 0BY

March 2020

Dear Audit Committee Members

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

This Audit Planning Report 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 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 on 25 March 2020, as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully



Stephen Reid, Partner
For and on behalf of Ernst & Young LLP
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Contents



The contents of this report are subject to the terms and conditions of our appointment as set out in our engagement contract of 2 October 2017. This report is made solely to the Audit Committee and management of North Tyneside Council in accordance with our engagement contract. Our work has been undertaken so that we might state to the Audit Committee and management of North Tyneside Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of North Tyneside Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



01

Overview of our 2019/20 audit strategy



Overview of our 2019/20 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year when compared to those identified in 2018/19.

Audit risks and areas of focus

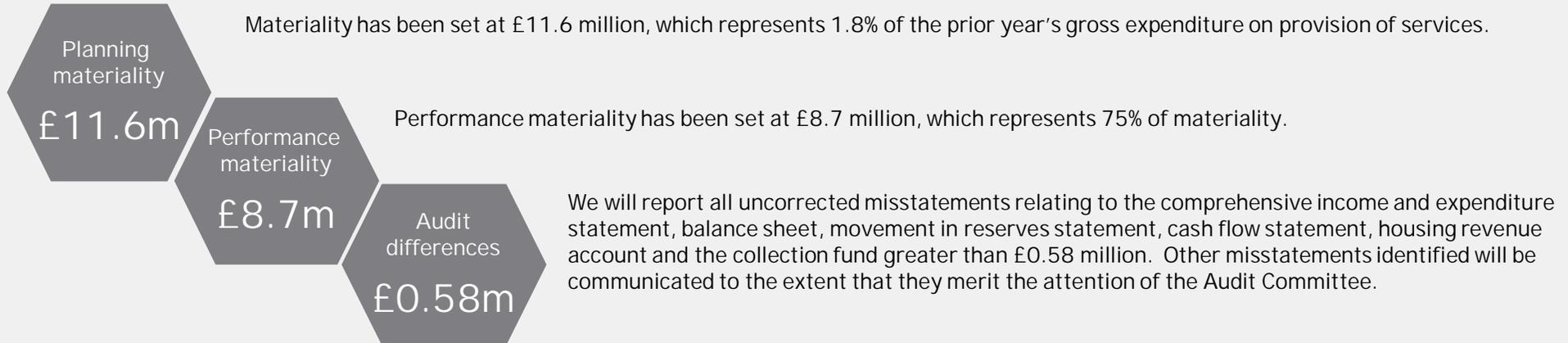
Risk / area of focus	Risk identified	Change from PY	Details
Risk of fraud in revenue and expenditure recognition	Fraud risk/ Significant risk	No change in risk or focus	Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.
Misstatements due to fraud or error	Fraud risk/ Significant risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.
Valuation of land and buildings	Inherent risk	Reduced risk	The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's financial statements and is 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 balance recorded in the balance sheet. There were no findings in the prior year in relation to these inputs and as such the risk has been reduced to an inherent level as opposed to significant.
Pension liability valuation	Inherent risk	No change in risk or focus	The pension liability is the most significant liability on the Council's balance sheet and is calculated through use of a number of actuarial assumptions. A small movement in these assumptions can have a material impact on the balance sheet.
IFRS 16 - Leases	Inherent risk	New risk for 2019/20	Implementation of IFRS 16 will be included in the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) for 2020/21. This Code has yet to be published, but disclosure of the anticipated impact of the new standard will be required within the 2019/20 financial statements.
Group financial statements	Inherent risk	No change in risk or focus	In previous years, the Council has not produced group financial statements on grounds of materiality. However, due to increasing activity in the Council's subsidiaries, we believe that it is important the Council reassess their group boundary and consider the need to produce group financial statements in 2019/20.

Overview of our 2019/20 audit strategy

Value for money risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Financial sustainability	Value for money risk	No change in risk or focus	The Council continues to operate in a challenging financial environment. The main risks to the Council's finances are reductions in central government funding, increased reliance on locally raised taxes, increased budget pressures and demand for services. These circumstances have resulted in the Council forecasting a pressure against budget of £3.5 million at the end of November 2019.

Materiality



Overview of our 2019/20 audit strategy

Audit scope

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

- Our audit opinion on whether the financial statements of the Council give a true and fair view of the financial position as at 31 March 2020 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources.

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

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

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

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

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



02

Audit risks



Our response to significant risks

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

	What is the risk?	What will we do?
<p>Risk of fraud in revenue and expenditure recognition*</p>	<p>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.</p>	<p>We plan to perform the following procedures to address the risk:</p> <ul style="list-style-type: none"> • Review and test revenue and expenditure recognition policies, including consideration of the recognition of grant income; • Review and discuss with management any accounting estimates relating to revenue or expenditure recognition, such as manual accruals, for evidence of bias; • Test capital additions recognised in year to ensure that they are capital in nature and should not have instead been recognised as expenditure in the Comprehensive Income and Expenditure Statement; and • Review a sample of expenditure transactions recorded in the ledger and payments made from bank accounts post year-end and confirm that the associated expenditure has been recorded in the correct period.
<p>Financial statement impact</p>	<p>Local authorities have a statutory duty to balance their annual budget and are operating in a financially challenged environment with reducing levels of government funding and increasing demand for services. Achievement of budget is critical to minimising the impact and usage of the Council's usable reserves and provides a basis for the following year's budget. Any deficit outturn against the budget is therefore not a desirable outcome for the Council and management, and therefore this desire to achieve budget increases the risk that the financial statements may be materially misstated.</p> <p>Our judgement is that the significant risk at the Council relates to the recognition of grants with terms and conditions attached, the potential improper capitalisation of revenue expenditure and the posting of year end accruals. We will therefore target our audit work in these areas.</p>	
<p>Misstatements that may occur in relation to the risk of fraud in revenue and expenditure recognition affect the income and expenditure accounts. These accounts had the following values in the 2018/19 financial statements:</p> <ul style="list-style-type: none"> • Gross income: £610.3 million • Gross expenditure: £645.4 million 		

Our response to significant risks (continued)

Misstatements due to fraud or error*

What is the risk?

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

As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

What will we do?

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

- Identifying fraud risks during the planning stages;
- Inquiry of management about risks of fraud and the controls put in place to address those risks;
- Understanding the oversight given by those charged with governance of management's processes over fraud;
- Consideration of the effectiveness of management's controls designed to address the risk of fraud;
- Determining an appropriate strategy to address those identified risks of fraud; and
- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;
- Review of accounting estimates for evidence of management bias; and
- Evaluating the business rationale for any significant unusual transactions.

Other areas of audit focus

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

What is the risk?	What will we do?
<p>Valuation of land and buildings</p> <p>The value of land and buildings represents a significant balance in the Council's financial statements and is subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements in respect of key assumptions and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>	<p>We plan to perform the following procedures to address the risk:</p> <ul style="list-style-type: none"> • Consider the work performed by the Council's valuer, Capita, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre); • Consider the annual cycle of valuations to ensure that land and buildings assets have been valued as part of a five-year rolling programme and investment properties have been valued on an annual basis as required by the CIPFA Code of Practice; • Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated; • Consider changes to useful economic lives as a result of the most recent valuation; and • Test accounting entries have been correctly processed in the financial statements.
<p>Pension liability valuation</p> <p>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 Tyne and Wear Pension Fund.</p> <p>The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2019, this totalled £492 million. The information disclosed is based on the IAS 19 report issued by the Council's actuary, AON Hewitt.</p> <p>Accounting for this scheme involves significant estimation and judgement, and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>We plan to perform the following procedures to address the risk:</p> <ul style="list-style-type: none"> • Liaise with the audit team of Tyne and Wear Pension Fund, to obtain assurances over the information supplied to the actuary in relation to North Tyneside Council; • Assess the work of the Pension Fund actuary (AON Hewitt) including the assumptions they have used, by relying on the work of PwC, the consulting actuaries commissioned by the PSAA for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and • Review and test the accounting entries and disclosures made within the Council's financial statements in relation to the pension disclosures.

Other areas of audit focus (continued)

What is the risk/area of focus?

IFRS16 – leases

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

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

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

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

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

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

What will we do?

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

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

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

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

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

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

Other areas of audit focus (continued)

What is the risk?

Group financial statements

In previous years, the Council has not produced group financial statements on grounds of materiality. However, due to increasing activity in the Council's subsidiaries, we consider that it is important the Council reassess their group boundary and the need to produce group financial statements in 2019/20.

What will we do?

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

- Review the Council's group boundary assessment to ensure that it is complete and all group entities have been identified;
- Review the Council's assessment of qualitative factors, such as whether the Council is exposed to any commercial risk through its involvement with the group entity, in order to ensure the assessment is appropriate; and
- Test the Council's quantitative assessment by agreeing all values included in the assessment to audited financial statements for each of the group entities.



03

Value for money risks





Value for money risks

Background

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

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

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

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

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

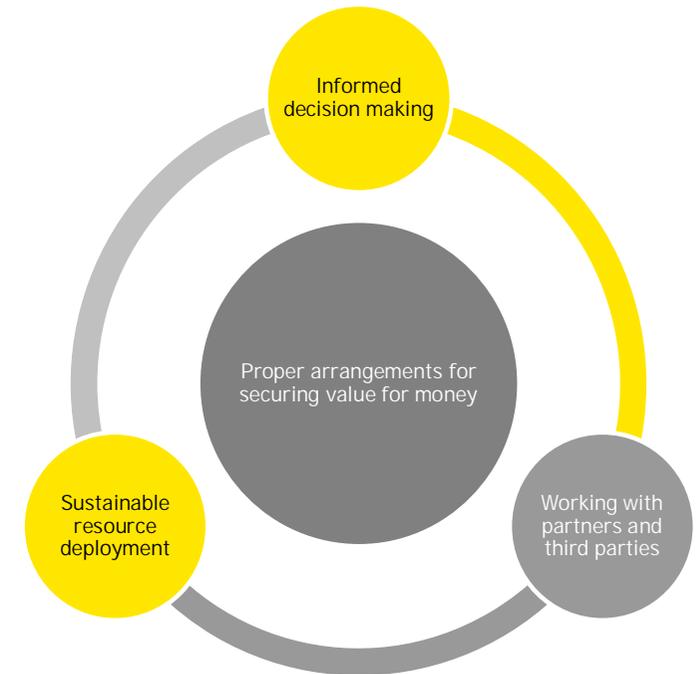
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your Annual Governance Statement.

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

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

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money, and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks, there is no requirement to carry out further work.

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





Value for money risks

Financial sustainability

What is the risk?

The Council continues to operate in a challenging financial environment. The main risks to the Council's finances are reductions in central government funding, increased reliance on locally raised taxes, increased budget pressures and demand for services.

At the end of November 2019, the Council was forecasting a pressure against budget of £3.5 million. This pressure is largely due to significant overspends in Health, Education, Care and Safeguarding, with Children's services forecasting a year end pressure of £4.6 million. In addition, the Council is required to make total savings of £10.5 million in 2019/20. There is therefore significant pressure on the Council's finances over the coming years.

What will we do?

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

- Select a sample of savings plans and assess their reasonableness, including testing of the assumptions used;
- Review the specific plans in place for Health, Education, Care and Safeguarding to understand how the Council plans to control the overspends in this area;
- Review the level of reserves to ensure they are sufficient to cover the Council's assessment of the minimum required to provide its statutory services; and
- Review the Medium Term Financial Plan and test the reasonableness of a sample of the assumptions used.



04

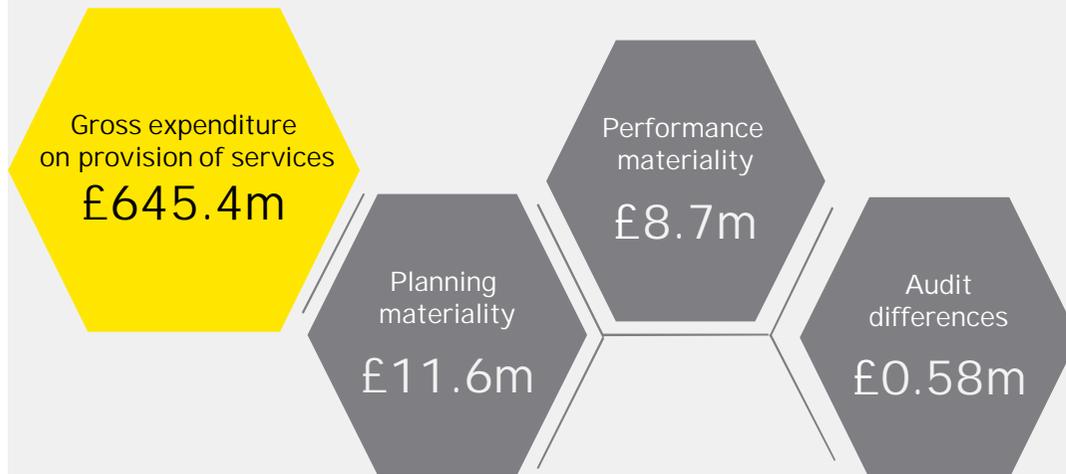
Audit materiality



Materiality

Materiality

For planning purposes, materiality for 2019/20 has been set at £11.6 million. This represents 1.8% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



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

Key definitions

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

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £8.7 million which represents 75% of planning materiality. We have used a threshold of 75% as this is the second year we have audited the Council and we did not encounter any significant control weaknesses in the prior year. As a result, we have increased our threshold to 75% from the previous 50% level.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements relating to the comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, housing revenue account and the collection fund greater than £0.58 million.

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

Specific materiality – We have set a materiality of nil for remuneration disclosures, members' allowances and exit packages which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to these.



05

Scope of our audit



Our audit process and strategy

Objective and scope of our audit

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

We issue an audit report that covers:

1. Financial statements audit

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

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

Procedures required by standards

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

Procedures required by the Code

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

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

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

Our audit process and strategy (continued)

Audit process overview

Our audit involves:

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

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

Analytics

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

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

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

Internal audit

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



06

Audit team



Audit team

The engagement team continues to be led by Stephen Reid (Partner), who will have responsibility for ensuring that our audit is high quality and delivers value to the Council. He will continue to be supported by Stuart Kenny (Senior Manager), who will be responsible for the day-to-day direction of audit work and are the key points of contact for the finance team.

Use of specialists

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

Area	Specialists
Valuation of Land and Buildings	Capita (management's valuation specialist)
Pensions disclosure	AON Hewitt (management's actuarial specialist) EY Actuaries

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

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

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



07

Audit timeline





Audit timeline

Timetable of communication and deliverables

Timeline

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

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

Audit phase	Timetable	Audit Committee timetable	Deliverables
Planning - Risk assessment and setting of scopes	December		
Walkthrough of key systems and processes	January		
	February		
Interim audit testing	March	Audit Committee	Audit Planning Report
	April		
	May		
Year end audit testing	June		
Year end audit testing (continues) Audit completion procedures	July	Audit Committee	Audit Results Report Audit opinions and completion certificates
	August		Annual Audit Letter



08

Independence



Introduction

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

Required communications

Planning stage	Final stage
<ul style="list-style-type: none"> ▶ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between you, your affiliates and directors and us; ▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▶ The overall assessment of threats and safeguards; ▶ Information about the general policies and process within EY to maintain objectivity and independence; and ▶ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard. 	<ul style="list-style-type: none"> ▶ 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 the 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 Reid, your audit engagement leader 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, there are no non-audit fees other than those relating to certification of claims and returns, and there are no business relationships. Therefore 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.

Relationships, services and related threats and safeguards

Other threats

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

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

EY Transparency Report 2019

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

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 30 June 2018 and can be found here:

https://www.ey.com/en_uk/who-we-are/transparency-report-2019

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 2020 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 1 April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.

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



09

Appendices



Appendix A

Fees

	Planned fee 2019/20	Scale Fee 2019/20	Final fee 2018/19
	£	£	£
Total Fee – Code work (Scale Fee)	TBC	85,200	85,200
Total Fee – Code work (Variation)	TBC	-	26,250*
Total Audit fee	TBC	85,200	111,450
Non-audit work – Housing Benefit certification work	TBC	6,550	6,550
Non-audit work – Other certification work	TBC	4,926	4,926
Total other non-audit services	TBC	11,426	11,426
Total fees	TBC	96,676	122,876

* In our 2018/19 Audit Results Report, which we presented in July 2019 to the Audit Committee, we highlighted that a fee variation was necessary due to a number of one off factors. These included the implementation of new accounting standards IFRS 9 and IFRS 15, the revaluation of the Council's shares in Newcastle International Airport Limited, our review of the Council's Group Accounts Assessment, the additional procedures required as a result of identifying two prior period adjustments and the additional procedures required in relation to the accounting for the McCloud judgement. We have agreed the additional fee included in the table above with management for these procedures.

Given the ongoing reviews into corporate reporting including the responsibilities of directors and the audit profession, there are a significant number of factors that continue to impact audit fees. We have discussed the impact on our audit fees of the changing audit environment with management and bring these to the attention of the Audit Committee. In summary:

- Recent high profile corporate failures have weakened public trust and confidence in both the auditing profession and business at large. Multiple ongoing regulatory reviews continue to reshape the corporate reporting environment and raise fundamental questions about the purpose, product and role of an external audit, as well as the accountability of auditors and those charged with governance.
- Financial reporting and decision making continues to become increasingly complex. Additionally, there has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address stakeholder understanding and regulatory expectations on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.

In continuing to respond to these factors we seek higher levels of corroborative evidence, including increasing sample sizes and engage with our internal specialists more extensively and on a wider array of matters. Additionally, we continue to increase our investment in data analytics tools to allow us to test more transactions to a greater level of detail and enhance audit quality. To support the increasing regulatory focus, we invest in our audit quality infrastructure. As a firm our compliance costs have doubled over the past five years.

Furthermore, on 10 February 2020, EY issued a letter to all Local Government clients who opted in to the Public Sector Audit Appointments Limited (PSAA) contract setting out our concerns regarding the future sustainability of the UK public audit profession. Although, the Council is not part of the PSAA contract the concerns included in the letter equally apply to the Council. We have shared this letter with management and will be having further discussions regarding the scale fee set for 2019/20 and potential variations as a result of this letter. We will report all variations that are agreed with management back to the Audit Committee.

The agreed fee presented is based on the following assumptions:

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

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

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

All fees exclude VAT

Fees

Summary of key factors

1. **Status of sector:** Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, speculative ventures and investments. This has also brought increasing risk about the financial sustainability/going concern of bodies given the current status of the sector.
2. **Audit of estimates:** There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.
3. **Regulatory environment:** Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice, are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.
4. **Resourcing:** As a result of the above, public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

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

To respond to these factors we have to:

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

Appendix B

Required communications with the Audit Committee

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

Our reporting to you

Required communications	 What is reported?	  When and where
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties	Engagement Contract
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	Engagement Contract
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified	Audit Planning Report – July 2020
Significant findings from the audit	<ul style="list-style-type: none"> • 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 – March 2020

Appendix B

Required communications with the Audit Committee (continued)

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

Appendix B

Required communications with the Audit Committee (continued)

		 Our reporting to you
 Required communications	 What is reported?	 When and where
Independence	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement associate partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> • 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 	<p>Audit Planning Report - March 2020</p> <p>Audit Results Report - July 2020</p>
External confirmations	<ul style="list-style-type: none"> • Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures 	Audit Results Report - July 2020
Consideration of laws and regulations	<ul style="list-style-type: none"> • Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of 	Audit Results Report - July 2020
Internal controls	<ul style="list-style-type: none"> • Significant deficiencies in internal controls identified during the audit 	<p>Audit Results Report - July 2020</p> <p>Annual Audit Letter - August 2020</p>

Appendix B

Required communications with the Audit Committee (continued)

		 Our reporting to you
Required communications	 What is reported?	 When and where
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report – July 2020
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report – July 2020
Auditor’s report	<ul style="list-style-type: none"> • Key audit matters that we will include in our auditor’s report • Any circumstances identified that affect the form and content of our auditor’s report 	Audit Results Report – July 2020
Fee reporting	<ul style="list-style-type: none"> • Breakdown of fee information when the Audit Planning Report is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work 	Audit Planning Report – March 2020 Audit Results Report – July 2020
Certification work	Summary of certification work undertaken	Certification Report – March 2021

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.
- Reading other information contained in the financial statements, including the statement that the annual report is fair, balanced and understandable, and that the Audit Committee's reporting appropriately addresses matters communicated by us to the Audit Committee, and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

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

Materiality determines:

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

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

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