Peterborough City Council

Provisional Audit Plan
Year ended 31 March 2020

9 March 2020

Building a better working world

Audit Committee
Peterborough City Council

9 March 2020

Dear Audit Committee Members

Provisional Audit Plan – 2019/20

We are pleased to attach our Provisional Audit Plan 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, 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 Provisional Audit 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. At the date of this report, our planning and interim procedures remain ongoing. We will inform the Audit Committee if there any significant changes or revisions once we have completed these procedures and will provide an update to the next meeting of the committee.

The Council's Chief Financial Officer and Chair of Audit Committee will have received a copy of the letter from Janet Dawson, our UK Government and Public Sector Assurance Leader dated 10 February 2020, which discusses the Sustainability of UK local public audit. The Council's finance team have attended a Chief Financial Officer forum held in our Cambridge office in January 2020 to discuss the proposed delivery plan for the 2019/2020 external audit. The proposed timetable for your external audit has been discussed in our planning meetings on the 13th February 2020 and also in an email sent by our Cambridge office lead, Mark Hodgson on the 14th February 2020. In section 7 of this audit plan we report an audit timeline to ensure we deliver a high quality audit in a timeframe agreed with officers.

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Audit Committee
Peterborough City Council

9 March 2020

Provisional Audit Plan – 2019/20 continued..

Our provisional audit plan responds to the current financial, strategic, operational and reputational risks facing the Council. The most significant event that has informed our audit risk assessment is the circumstances which have led to the Council's application to the Ministry of Housing, Communities and Local Government (MHCLG) for a capitalisation direction of £10million as part of setting its 2020/2021 budget. We have reviewed and noted the concerns expressed by the Council's Chief Financial Officer in the robustness statement included in the 2020/2021 budget papers presented to the Council's Cabinet meeting on the 25th February 2020.

Whilst we have no significant concerns on the arrangements the Council has put in place to date to engage MHCLG officials, local stakeholders and public sector partners on the actions, assumptions and assertions set out in its 2020/2021 budget, we are concerned about the increasing fragility of the Council's short, medium and longer term financial position. Over the next month, we will determine whether to issue a written recommendation to the Council under section 24 (schedule 7) of the Local Audit and Accountability Act 2014. At this stage, we think such a written recommendation will have the impact on assisting in monitoring the Council's response and progress in securing its future financial resilience and direct the Council to report the results of this activity in the public domain. To inform our final view on this matter, we are undertaking audit procedures now to establish the current timetable, risks and implications of a decision by MHCLG on the Council's application for a capitalisation direction and the robustness of assumptions supporting any immediate actions the Council are taking in response.

We have updated our audit risk assessment to respond to the heightened risks and public profile associated with the Council's increasingly fragile financial position. This includes a reduction to our audit performance materiality compared to the prior year as well as increased audit risks and testing associated with accounting judgements that could be used to provide a short to medium term revenue and general fund benefit to the Council. These additional audit risks and procedures will increase the scope of our work and lead to additional audit fees. We have set out our provisional estimate of the implications for the scope of our work and audit fee throughout this report.

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 23 March 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully
Neil Harris

Associate Partner
For and on behalf of Ernst & Young LLP
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Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the via 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 Committee and management of Peterborough City Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Peterborough City 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 Peterborough City 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.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	Fraud 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. The Council is under significant financial pressure to achieve a balanced budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way to achieve these targets and one way management override can manifest. As management is in a unique position to manipulate accounting records directly or indirectly by overriding controls that otherwise appear to be operating effectively, we have identified the key areas at risk of manipulation as set out below.
Misstatements due to fraud or error – the incorrect capitalisation of revenue expenditure and REFCUS	Fraud risk	No change in risk or focus	We consider the risk applies to capitalisation of revenue expenditure and revenue expenditure funded from capital under statute (REFCUS). Management could manipulate revenue expenditure by incorrectly capitalising expenditure which is revenue in nature and should be charged to the comprehensive income and expenditure account.
Misstatements due to fraud or error – the incorrect application of MRP accounting	Fraud risk	Change in audit focus	The Authority must make an annual contribution from revenue to reduce its overall borrowing requirement. This is termed the Minimum Revenue Provision (MRP). The MRP is determined prudently in accordance with statutory guidance. Over the last 18 months, the Authority's approach to MRP has been subject to media attention as well as scrutiny by Ministry of Housing, Communities & Local Government (MHCLG). Given this level of scrutiny and that MRP could be manipulated to artificially reduce expenditure we have identified the MRP calculation as a significant risk.
Misstatements due to fraud or error – inappropriate use of capital receipts	Fraud Risk	New area of focus	The adjustments between accounting basis and funding basis under regulation changes the amounts charged to General Fund balances. Regulations are varied and complex, resulting in a risk that management misstatement accounting adjustments to manipulate the General Fund balance. We have identified the risk to be highest for adjustments concerning the application of capital receipts.

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.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Valuation of property, plant and equipment assets under depreciated replacement cost model	Significant Risk	No change in risk or focus	Property, plant and equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet. For assets valued using depreciated replacement cost (DRC) this risk is heightened due to the specialised nature of the assets and insufficient availability of market-based evidence to assist the valuation. As the Council's DRC asset base is significant, and the outputs from the valuer are subject to estimation, there is a significant risk PPE may be under/overstated or the associated accounting entries incorrectly posted. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.
Valuation of other Land and Buildings and Investment Properties	Inherent Risk	No change in risk or focus	The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts 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.
Pension Liability Valuation & Pensions Assets	Inherent Risk	No change in risk or focus	The Council makes extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Cambridgeshire County Council. 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 £332 million. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf.

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.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Recoverability of NHS Accounts Receivable Balances	Inherent Risk	New area of focus	The Council has a significant accounts receivable (debtor) balance. As at 31 March 2019 the balance was £53.6million. There is a risk that the Council may not receive the payments from their suppliers. We are aware that a significant amount of the balance relates to one NHS debtor of £11million. The Council is working closely with NHS bodies to resolve the recoverability of the balance. Given that there might be some subjectivity to the recoverability of these debtors. we will test the Council's judgements to third party and corroborative evidence. We have therefore raised this as an inherent risk in our audit strategy.
Group Accounting and the scope of the group audit	Inherent Risk	New area of focus	The Council will be preparing group accounts for the first time in 2019/20 due to the consolidation of the Live Peterborough Limited financial statements with the single entity Council financial statements. We identify this as an inherent risk as the Council has not prepared group accounts in the past and this can be a complex area of accounting. Once we have established the transactions and accounting judgements for the group accounts and consolidation of the subsidiary company, we will finalise the impact this has on our group audit scope and procedures.

In addition to the risks outlined above we have identified an area of audit focus.

Area of focus	Change from PY	Details
Implementation of new auditing and accounting standards	New area of focus	**IFRS 16 Leases:** 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 published, but in July 2019 CIPFA/LASAAC issued 'IFRS 16 leases and early guide for practitioners'. There will be some disclosure requirements for the 2019/20 statement of accounts. **Going Concern Compliance with ISA 570:** This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after. The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the Council will be the audit of the 2020/21 financial statements.

Overview of our 2019/20 audit strategy

Materiality - Peterborough City Council - Single Entity financial statements

Planning materiality

£5.24m

Materiality for the Council's financial statements has been set at £5.240 million, which represents 1.0% of the prior years gross expenditure on net cost of services plus financing and investment expenditure. In the prior year we applied a threshold of 1.8%. We have judged it appropriate to adopt a lower level of materiality based on the risks we have identified around the Council's budget position and the higher public interest and profile this has.

Performance materiality

£3.93m

Performance materiality has been set at £3.930 million, which represents 75% of materiality.

Audit differences

£0.26m

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement and cash flow statement) greater than £0.262 million. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Committee.

We also identify areas where misstatement at a lower level than our overall materiality level might influence the reader and develop an audit strategy specific to these areas, including:

- Remuneration disclosures including councillor allowances: we will agree all disclosures back to source data, and councillor allowances to the agreed and approved amounts.
- Related party transactions we will test the completeness of related party disclosures and the accuracy of all disclosures by checking back to supporting evidence.

Overview of our 2019/20 audit strategy

Audit scope

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

- Our audit opinion on whether the financial statements of Peterborough City Council and Group 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 (Value for Money).

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, the introduction of new accounting standards such as IFRS 9 and 15 in recent years 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 Peterborough City's audit, we will discuss these with management as to the impact on the scale fee.

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.

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.

As part of our work to identify fraud risks during the planning stages, we have identified those areas of the accounts that involve management estimates and judgements as the key areas at risk of manipulation.

These are set out on the following pages.

What will we do?

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

- Identifying fraud risks during the planning stages.
- Inquiry of management about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.
- Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements.

To address the residual risk of management override we perform specific procedures which include:

- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, for example using our journal tool to focus our testing on specific journals such as those created at unusual times or by staff members not usually involved in journal processing;
- Assessing key accounting estimates for evidence of management bias; and
- Evaluating the business rationale for significant unusual transactions

Our response to significant risks (continued)

Misstatements due to fraud or error - the incorrect capitalisation of revenue expenditure and REFCUS *

Financial statement impact

We have identified a risk of expenditure misstatements due to fraud or error that could affect the income and expenditure accounts.

We consider the risk applies to capitalisation of revenue expenditure and REFCUS and could result in a misstatement of cost of services reported in the comprehensive income and expenditure statement.

In 2018/19 the Council incurred £95.9 million capital expenditure (of which REFCUS represented £20.5 million).

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What is the risk?

The Council is under significant financial pressure to achieve budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way to achieve these targets.

We consider the risk applies to capitalisation of revenue expenditure and revenue expenditure funded from capital under statute (REFCUS). Management could manipulate revenue expenditure by incorrectly capitalising expenditure which is revenue in nature and should be charge to the comprehensive income and expenditure account.

What will we do?

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

- Sample testing, at a lower testing threshold, additions to property, plant and equipment to ensure that they have been correctly classified as capital and included at the correct value in order to identify any revenue items that have been inappropriately capitalised; and
- Using our data analytics tool to identify and test journal entries that move expenditure into capital codes.

Our response to significant risks (continued)

Misstatements due to fraud or error - the incorrect application of MRP accounting *

Financial statement impact

We have identified a risk of expenditure misstatements due to fraud or error that could affect the income and expenditure accounts.

We consider the risk applies to the calculation of the minimum revenue provision calculation and could result in a misstatement of cost of services reported in the comprehensive income and expenditure statement.

What is the risk?

The Council is under significant financial pressure to achieve budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way to achieve these targets.

We consider the risk applies to application and calculation of the minimum revenue provision.

The Authority must make an annual contribution from revenue to reduce its overall borrowing requirement. This is termed the Minimum Revenue Provision (MRP). The MRP is determined prudently in accordance with statutory guidance.

Over the last 18 months, the Authority's approach to MRP has been subject to media attention as well as scrutiny by Ministry of Housing, Communities & Local Government (MHCLG). Given this level of scrutiny and that MRP could be manipulated to artificially reduce expenditure we have identified the MRP calculation as a significant risk.

What will we do?

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

- Testing the application of MRP to ensure the calculation met the statutory guidance;
- Re-performing the MRP calculation; and
- Engaging our EY MRP technical specialist to review the Authority's MRP policy and disclosure.

Audit risks

Our response to significant risks (continued)

Misstatements due to fraud or error – inappropriate use of capital receipts *

Financial statement impact

We have identified a specific risk of misstatements due to fraud or error that could affect the income and expenditure accounts and the balance sheet.

We consider the risk applies to the application of capital receipts in the comprehensive income and expenditure statement (CIES) and balance sheet (via the capital financing requirement).

In 2018/19 the Council applied £19.4 million of capital receipts funding in the Capital Financing Requirement.

What is the risk?

The Council is under significant financial pressure to achieve its revenue budget and maintain reserve balances above the minimum approved levels. Manipulating expenditure is a key way of achieving these targets.

We consider the risk applies to the application and use of capital receipts in the financial statements.

The adjustments between accounting basis and funding basis under regulation changes the amounts charged to General Fund balances. Regulations are varied and complex, resulting in a risk that management misstatement accounting adjustments to manipulate the General Fund balance. We have identified the risk to be higher for adjustments concerning the application of useable capital receipts and deferred capital receipts.

What will we do?

Our approach will focus on:

- Sample testing the application of capital receipts in the capital financing requirement to ensure they meet the definition of sources of funding;
- Sample testing deferred capital receipts to ensure any conditions have been correctly applied; and
- Using our data analytics tool to identify and test journal entries adjustments that impact capital receipts.

Our response to significant risks (continued)

Valuation of property, plant and equipment assets under depreciated replacement cost model

Financial statement impact

We have identified a specific risk of misstatements due to fraud or error that could affect the balance sheet.

We consider the risk applies to the valuation of property, plant and equipment using the depreciated replacement cost method in the balance sheet.

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What is the risk?

Property, plant and equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges.

Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet. For assets valued using depreciated replacement cost (DRC) this risk is heightened due to the specialised nature of the assets and insufficient availability of market-based evidence to assist the valuation.

As the Council's DRC asset base is significant (£246 million), and the outputs from the valuer are subject to estimation, there is a significant risk PPE may be under/overstated or the associated accounting entries incorrectly posted.

ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.

What will we do?

Our approach will focus on:

- Consider the work performed by the Council's valuers, 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 DRC valuations (e.g. floor plans to support valuations based on price per square metre and the specialised nature of the assets);
- Consider the use of EY valuation specialists to review a sample of the underlying assumptions used to value any material specialist DRC assets;
- Review DRC 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.

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?	What will we do?
Valuation of other Land and Buildings and Investment Properties The fair value of Property, Plant and Equipment (PPE) (£318 million) and Investment Properties (IP) (£29.6 million) represent significant balances in the Council's accounts 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 will: ▸ Consider the work performed by the Council's valuers, 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 assets have been valued within a 5 year rolling programme as required by the Code for PPE and annually for IP. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer; ▸ 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.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Pension Liability Valuation & Pensions Assets The Council makes extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Cambridgeshire County Council. 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 £332 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. We undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: ▸ Liaise with the auditors of Cambridgeshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Peterborough City Council. This includes identifying, documenting and reviewing the controls over the accuracy and completeness of information extracted from the Membership Administration system and provided to the actuary for the 2019 triennial valuation dataset; ▸ Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used, by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all local government sector auditors, and by 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 IAS19 considering fund assets and the Council's liability.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Recoverability of NHS Accounts Receivable Balances The Council has a significant accounts receivable (debtor) balance. As at 31 March 2019 the balance was £53.6 million. We are aware that a significant amount of the balance relates to one NHS debtor of £11million. The Council is working closely with NHS bodies on the recoverability of the debtor. There is a risk that the Council may not receive the payments from their NHS suppliers. Given that there might be some subjectivity to the recoverability of these debtors the Council will need to consider the level of any provision for bad debts. We have therefore raised as an inherent risk in our audit strategy.	We will: ‣ Corroborate the relevant NHS debtor balances and ensure that the amounts consistent with confirmations received directly from the NHS bodies (third party information); and ‣ Test any NHS bad debt provisions or NHS debtor write-offs to ensure that these are calculated in line with IAS 37.
Group Accounting In July 2018 the Council incorporated Live Peterborough Limited, a local authority trading company (LATCo), with the Council as the sole owner. Activity has increased in the company in 2019/20 to a level that is considered material. This will require the Council to prepare group accounts. We identify this as an inherent risk as the Council has not prepared group accounts in the past and this can be a complex area of accounting.	We will: ‣ Review the group assessment prepared by the Council, ensuring that the accounting framework and accounting policies are aligned to the Peterborough City Council group; ‣ Scope the audit requirements for Live Peterborough Limited based on their significance to the group accounts. Liaising with the EY external auditor of Live Peterborough Limited and potentially issuing group instructions that detail the required audit procedures they are to undertaken order to provide us with assurance for the opinion we will issue on the group accounts; ‣ Ensure the appropriate consolidation procedures and the Code of Practice are applied when preparing the Council group accounts.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
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 published, but in July 2019 CIPFA/LASAAC issued 'IFRS 16 leases and early guide for practitioners'. This early guidance provides comprehensive coverage of the requirements of the forthcoming provisions, including: ▸ the identification of leases ▸ the recognition of right-of-use assets and liabilities and their subsequent measurement ▸ treatment of gains and losses ▸ derecognition and presentation and disclosure in the financial statements, ▸ the management of leases within the Prudential Framework. The guidance also covers the transitional arrangements for moving to these new requirements, such as: ▸ the recognition of right-of-use assets and liabilities for leases previously accounted for as operating leases by lessees ▸ the mechanics of making the transition in the 2020/21 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).	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 and some narrative disclosures are required for 2019/20. 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/area of focus?	What will we do?
Going Concern Compliance with ISA 570 This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after. The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the Council will be the audit of the 2020/21 financial statements. The revised standard increases the work we are required to perform when assessing whether the Council is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards; and we have therefore judged it appropriate to bring this to the attention of the Audit Committee. The CIPFA Guidance Notes for Practitioners 2019/20 accounts states 'The concept of a going concern assumes that an authority's functions and services will continue in operational existence for the foreseeable future. The provisions in the Code in respect of going concern reporting requirements reflect the economic and statutory environment in which local authorities operate. These provisions confirm that, as authorities cannot be created or dissolved without statutory prescription, they must prepare their financial statements on a going concern basis of accounting.' 'If an authority were in financial difficulty, the prospects are thus that alternative arrangements might be made by central government either for the continuation of the services it provides or for assistance with the recovery of a deficit over more than one financial year. As a result of this, it would not therefore be appropriate for local authority financial statements to be provided on anything other than a going concern basis.'	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. While the Council are not one of the three entity types listed, we will ensure compliance with any updated reporting requirements; ▸ a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when we draw our conclusions on going concern; and ▸ necessary consideration regarding the appropriateness of financial statement disclosures around going concern. The revised standard extends requirements to report to regulators where we have concerns about going concern. We will discuss the detailed implications of the new standard with finance staff during 2019/20 ahead of its application for 2020/21.

03 Value for Money Risks

Value for Money

Background

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

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

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

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

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

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

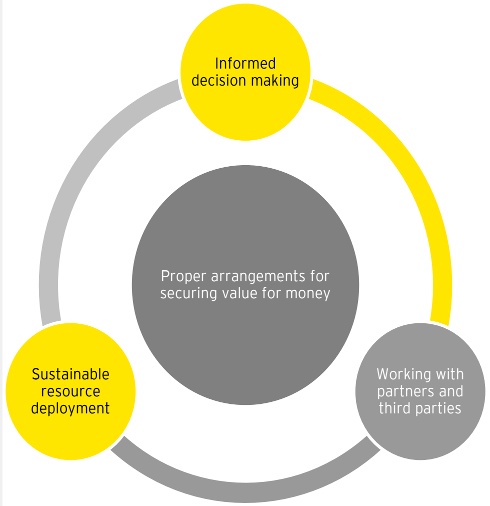
We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

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

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level.

As part of our value for money planning risk assessment for 2019/20, we will consider the steps taken by the Council to consider the impact of Brexit and Coronavirus on its future service provision, medium-term financing and investment values. Although the precise impacts cannot yet be modelled, we would expect that Authorities will be carrying out scenario planning and that Brexit and Coronavirus impacts will feature on operational risk registers. Our risk assessment will consider both the potential financial impact of the issues we identify, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders.

We have identified one significant risk in the slide below. We will continue to update our assessment of risks associated with value for money throughout the audit and will update you if any additional risks are identified.



Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
We reported in previous years our views on the financial resilience of the Council and in particular the scale of the financial challenge it faces. Like most local authorities, the Council's finances continue to be stretched. There are significant gaps in the budget over the period of the Medium Term Financial Strategy which have still not been addressed. The cumulative unmitigated budget gap to 2022/23 is £30.6 million and this also includes the successful delivery of £26.3 million of savings up to that period and some savings which are still subject to finalisation. It also includes a £10million capitalisation direction currently with MHCLG for approval. The Chief Financial Officer has expressed concerns on the fragility of the Council's financial position in the robustness statement presented to 25th February 2020 Cabinet supporting the 2020/2021 budget. In particular, there is a risk the Chief Financial Officer could trigger the production of a Section 114 report if the Council could not report a balanced budget for 2020/21, where: 1. the Capitalisation Direction approval is not confirmed by 31 March 2020; or 2. realistic transformational plans, for reducing the cost of service delivery required to deliver a balanced and sustainable budget for future years, are not developed, and implementation commenced by July 2020. Whilst the Council is taking action to identify ways to bridge the gaps, there remains a significant risk to its financial resilience.	• Taking informed decisions; and • Deploying resources in a sustainable manner.	Our approach will focus on: Phase 1 – Financial Resilience Concerns (March to April 2020): ‣ Robust review of the Council's Medium Term Financial Strategy and the concerns raised by the Chief Financial Officer, including correspondence with MHCLG on the capitalisation direction application; ‣ Developing an understanding of how the Council identifies its budget gaps and risk mitigations; ‣ Consideration of exercising our statutory powers at this point (by April 2020) and if appropriate issuing a statutory written recommendation under section 24 (schedule 7) of the Local Audit and Accountability Act 2014. Phase 2 – Council's Response to Financial Resilience Concerns (April to July 2020): ‣ Developing an understanding of how the Council quantifies and quality assures its savings plans; ‣ Reviewing the extent to which the Council is addressing the future budget gaps identified within its Medium Term Financial Strategy, including the robustness of assumptions and judgements associated with savings and transformation plans. For both of these areas, we will consider using specialist support to work with the audit team in reviewing, challenging and exercising appropriate professional scepticism on the savings and transformation plans.

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04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2019/20 has been set at £5.240 million. This represents 1% of the Council's prior year gross expenditure on net cost of services plus financing and investment expenditure and other operating expenditure. This value has reduced from the 1.8% value used in the prior year due to the risks we have raised around the Council's financial position. We have provided supplemental information about audit materiality in Appendix C.

Expenditure for Materiality purpose
£524.20m

Planning materiality
£5.24m

Performance materiality
£3.93m

Audit differences
£262,000

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 £3.93 million which represents 75% of planning materiality. We have considered a number of factors such as the number of errors in the prior year and any significant changes when determining the percentage of performance materiality. We have used the higher end of the range.

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, balance sheet and collection fund that have an effect on income or that relate to other comprehensive income.

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 Committee, or are important from a qualitative perspective.

Specific materiality – We have set a lower materiality for Senior Officer's Remuneration, Members' Allowances and Exit Packages disclosures 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 this.

Group materiality – We will update the Committee at the next available opportunity about the materiality level we have used in the audit of the group accounts. Given the size of Live Peterborough Limited this is unlikely to be significantly different from the values presented here.

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 and Ireland).

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

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

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

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

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

Scope of our audit

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.

Our intention is to carry out a fully substantive audit in 2019/20 as we believe this to be the most efficient audit approach. Although we are therefore not intending to rely on individual system controls in 2019/20, the overarching control arrangements form part of our assessment of your overall control environment and will form part of the evidence for your Annual Governance Statement.

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 Committee.

Internal audit:

As in prior years we will 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 work, where they raise issues that could have an impact on the financial statements.

Scope of our audit

Earlier deadline for production of the financial statements

The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that 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.

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

- Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, group accounts, financial resilience challenges, speculative ventures and investments.
- Some local authorities have a shortage of financial reporting skills, capabilities and weaknesses in audit readiness (including keeping pace with technological advancement in data management and processing for audit).
- There has been a significant increase in the specialised skills, time and cost required by auditors to address regulatory expectations. This includes responding to regulator feedback and a zero tolerance on audit quality failures.
- 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.

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In order to ensure we are able to adhere an agreed timescale to complete our audit, we are supporting the Council by undertaking the following actions:

- Working with the Council to engage early in complex or challenging accounting areas, such as group accounting.
- Facilitating faster close workshops to provide an interactive forum for Local Authority accountants and auditors to share good practice and ideas to enable us all to achieve a successful faster closure of accounts for the 2019/20 financial year.
- Working with the Council to improve the use of EY Client Portal. This will streamline our audit requests through a reduction of emails and improved means of communication, while providing on-demand visibility into the status of audit requests and the overall audit status. Effective use of the portal also reduces the risk of duplicate requests and provides better security of sensitive data.
- Agreeing the team and timing of each element of our work with you and matching that to officer availability.
- Agreeing the supporting working papers that we require to complete our audit, and ensure you understand what we consider to be good quality audit evidence.

We held a workshop on 10 January 2020 with senior officers from across the region who are responsible for signing the financial statements and supporting their teams to provide supporting working papers. The workshop aimed to provide clarity around the pressures of delivering high quality audits in the current environment and discussed our plan to ensure we deliver a high quality audit in a timeframe agreed with officers. It also provided an opportunity for officers to ask questions in an open and transparent forum.

If you are unable to meet key dates within our agreed timetable, we will notify you of the impact on the timing of your audit, which may be that we postpone your audit until later in the year and redeploy the team to other work to meet deadlines elsewhere. Where additional work is required to complete your audit, due to additional risks being identified, additional work being required as a result of scope changes, or poor audit evidence, we will notify you of the impact on the fee and the timing of the audit. Such circumstances may result in a delay to your audit while we complete other work elsewhere.

06 Audit team

Audit team and use of specialists

Audit team

The engagement team is led by Neil Harris who takes over from Suresh Patel. Neil has significant public sector audit experience, with a portfolio of Local Authorities (including upper tier Councils) and Local Government Pension Funds and is a member of the Chartered Institute of Public Finance and Accountancy (CIPFA).

Neil is supported by Dan Cooke, Manager, who is responsible for the day-to-day direction of audit work and is the key point of contact for the chief accountant. This will be Dan's second year as manager on the audit.

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 we expect either EY or third party specialists provide input for the current year audit are:

Area	Specialists	
	EY	Council
Valuation of Land and Buildings	Real Estates team	Wilkes Head & Eve & NPS
Pensions disclosure	EY Actuaries	Hymans
MRP accounting	EY MRP Specialist	N/A
Financial Resilience	EY Advisory	N/A

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 Plan

Reporting our independence, risk assessment, planned audit approach and the scope of our audit

Audit Results Report

Reporting our conclusions on key judgements and estimates and confirmation of our independence

Annual Audit Letter

The Annual Audit Letter will be provided following completion of our audit procedures

Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov

Planning

Substantive testing

Planning

Risk assessment and setting of scopes

Walkthroughs

Walkthrough of key systems and processes

Year End Audit

Work begins on our year end audit. This is when we will complete any substantive testing not completed at interim

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 Neil Harris, 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.

To date we have not provided any services which are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01. Any provision of services would need to be 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 approximately 0%.

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.

Independence

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 communications

EY Transparency Report 2019
Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year end 30 June 2019: https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/$FILE/ey-uk-2019-transparency-report.pdf

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

09 Appendices

Appendix A

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Scale fee 2019/20	Final Fee 2018/19
	£	£
Total Fee – Code work	83,570 (Note 2)	106,334 (Note 1)
Total fees	TBA	106,334

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All fees exclude VAT

Note 1: The 2018/19 Code work includes an additional fee of £22,764, which relates to additional work for significant risks including MRP, PFI, PPE Valuations and value for money risks around financial resilience and contracts. We agreed the variation with officers and the PSAA.

Note 2: For 2019/20, the scale fee will be impacted by a range of factors (see following page) which will result in additional work. The issues we have identified at the planning stage which will impact on the fee include:

- The lowering of our audit materiality from the prior year and the impact this has on our audit testing across all of the Council's primary financial statements and supporting notes.
- The need to scope and audit the group accounts for the first time.
- The need to audit the significant and heightened risks presented in this audit plan, which includes incorrect capitalisation of expenditure, MRP and incorrect use of capital receipts.
- The need to engage EY Real Estate to review the valuation of DRC assets.
- The need to engage our advisory experts to support our assessment of the Council's future plans to address concerns on its future financial resilience.

We will continue to discuss the impact of these factors with management and the impact on the final fee.

At this stage, our estimate is that these changes in audit scope for our 2019/2020 external audit which are not assumed in your scale fee will lead to a £77,000 increase in the fee. Our estimate of the proposed fee is an increase from £83,570 to £160,570. During the course of our audit, we will provide management with an estimate and supporting breakdown to just each element of our additional fees. Our additional fees are subject to approval by PSAA.

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

The agreed fee presented is based on the following assumptions:

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

If any of the above assumptions prove to be unfounded, we will also 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.

Fees (continued)

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 Peterborough City Council the extent of audit procedures now required mean it will take approximately 2,000 hours to complete a quality audit. A commercial benchmark for this size of external audit would be in the region of £200,000. Your scale fee is £83,570 and our current estimate is a final fee of £160,570.

Summary of key factors

1. **Status of sector.** Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, speculative ventures and investments. This has also brought increasing risk about the financial sustainability / going concern of bodies given the current status of the sector.

   - To address this risk our procedures now entail higher samples sizes of transactions, the need to increase our use of analytics data to test more transactions at a greater level of depth. This requires a continual investment in our data analytics tools and audit technology to enhance audit quality. This also has an impact on local government with the need to also keep pace with technological advancement in data management and processing for audit.

2. **Audit of estimates.** There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.

   - To address these findings, our required procedures now entail higher samples sizes, increased requirements for corroborative evidence to support the assumptions, use of our internal specialists and increased correspondence with external specialists.

3. **Regulatory environment.** Other pressures come from the changing regulatory landscape and audit market dynamics:

   - Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.

   - This means continual investment in our audit quality infrastructure in response to these regulatory reviews, the increasing fines for not meeting the requirements plus changes in auditing and accounting standards. As a firm our compliance costs have now doubled as a proportion of revenue in the last five years. The regulatory lens on Local Audit specifically, is greater. We are three times more likely to be reviewed by a quality regulator than other audits, again increasing our compliance costs of being within this market.

Fees (continued)

Summary of key factors (cont'd)

4. As a result Public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

   - We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality.

   - We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.

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Next steps

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

Appendix B

Required communications with the Audit 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.	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 Plan – 27 March 2020
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 – September/October 2020

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Major Local Authorities	For the audits of financial statements of public interest entities our written communications to the Audit Committee include: ▶ A declaration of independence ▶ The identity of each key audit partner ▶ The use of non-member firms or external specialists and confirmation of their independence ▶ The nature and frequency of communications ▶ A description of the scope and timing of the audit ▶ Which categories of the balance sheet have been tested substantively or controls based and explanations for significant changes to the prior year, including first year audits ▶ Materiality ▶ Any going concern issues identified ▶ Any significant deficiencies in internal control identified and whether they have been resolved by management ▶ Actual or suspected non-compliance with laws and regulations identified relevant to the Audit Committee ▶ The valuation methods used and any changes to these including first year audits ▶ The scope of consolidation and exclusion criteria if any and whether in accordance with the reporting framework ▶ The identification of any non-EY component teams used in the group audit ▶ The completeness of documentation and explanations received ▶ Any significant difficulties encountered in the course of the audit ▶ Any significant matters discussed with management ▶ Any other matters considered significant	Audit Plan – 27 March 2020 Audit Results Report – September/October 2020

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Appendix B

Required communications with the Audit 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 – September/October 2020
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 – September/October 2020
Fraud	▸ 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 – September/October 2020
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 – September/October 2020

Appendix B

Required communications with the Audit 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	Audit Results Report – September/October 2020 Audit Plan – 27 March 2020
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report – September/October 2020
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 Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Committee may be aware of	Audit Results Report – September/October 2020
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit Results Report – September/October 2020

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Group audits	▸ An overview of the type of work to be performed on the financial information of the components ▸ An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components ▸ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work ▸ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ▸ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Audit Results Report – September/October 2020 Audit Plan – 27 March 2020
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report – September/October 2020
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report – September/October 2020
Auditors report	▸ 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 – September/October 2020
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 Results Report – September/October 2020 Audit Plan – 27 March 2020

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	▸ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. ▸ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's 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, including the board's statement that the annual report is fair, balanced and understandable, the Audit Committee reporting appropriately addresses matters communicated by us to the Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▸ Maintaining auditor independence.

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Appendix C

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 Council 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.