

A photograph of a meeting table with several white papers and documents spread across it. Several hands are visible, pointing at different sections of the papers, suggesting a collaborative review or discussion. A smartphone is also visible on the table. The background is slightly blurred, focusing attention on the documents and hands.

Northumberland County Council

Audit planning report

Year ending 31 March 2019

March 2019

Private and Confidential
Northumberland County Council Audit Committee
County Hall
Morpeth
NE61 2EF

March 2019

Dear Audit Committee Members

Audit planning report

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2017/18 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 Audit Committee's service expectations.

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

This report is intended solely for the information and use of the Audit 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 27 March 2019 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
Enc

Contents



The contents of this report are subject to the terms and conditions of our appointment as set out in our engagement contract of 20 December 2017. This report is made solely to the Audit Committee and management of Northumberland County Council in accordance with our engagement letter. Our work has been undertaken so that we might state to the Audit Committee and management of Northumberland County 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 Northumberland County 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 2018/19 audit strategy



Overview of our 2018/19 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

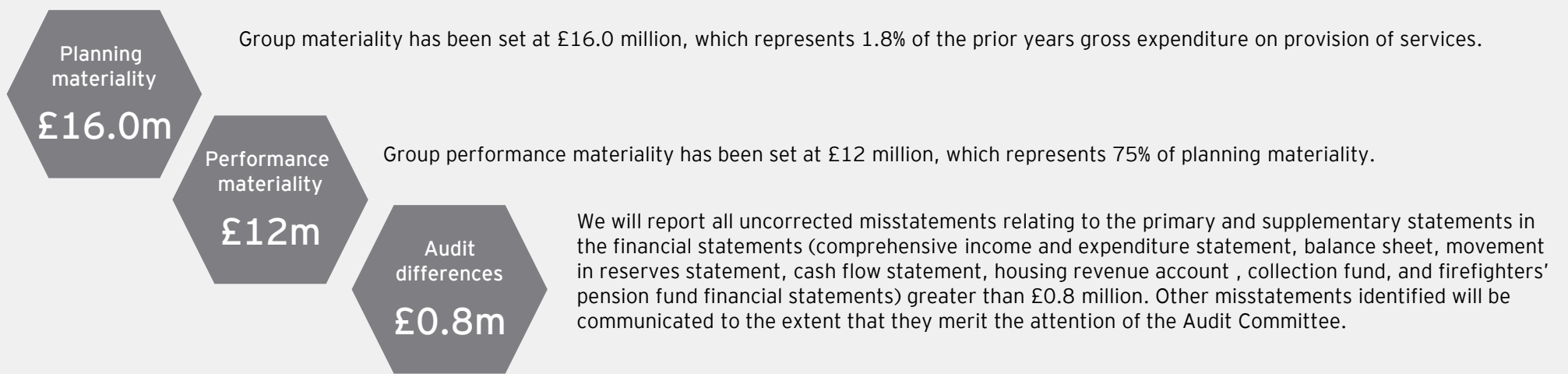
Risk / area of focus	Risk identified	Change from PY	Details
Risk of fraud in revenue and expenditure recognition	Fraud risk	No change in risk or focus	Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified 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.
Risk of fraud and 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.
Valuation of land and buildings	Significant risk	Increase in focus for this year	Land and buildings is the most significant balance on the Council's balance sheet. The valuation of land and buildings is subject to a number of assumptions and judgements. A small movement in these assumptions can have a material impact on the financial statements. As there has been a change in valuer, and there are challenging economic conditions surrounding retail property, we have escalated this to a significant risk for 2018/19.
Valuation of pension liability	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.
Transfer of trade and activities from the Arch Group to Advance Northumberland	Inherent risk	New risk for this year	The trade and activities of the Arch Group were transferred to Advance Northumberland, a new wholly owned subsidiary company of the Council in November 2018. There will be some complex accounting in the subsidiary entities to account for the transaction which will be significant for the Council's group financial statements.

Overview of our 2018/19 audit strategy

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Implementation of new accounting standards	Inherent risk	New risk for this year	The 2018/19 CIPFA Code of practice on local authority accounting has adopted the requirements of International Financial Reporting Standard ('IFRS') 9 - financial instruments and IFRS 15 - Revenue from contracts with customers. These standards may impact the way in which the Council accounts for its financial instruments and recognises revenue and introduce a number of new disclosure requirements for consideration.
Upgrade of Oracle General Ledger	Inherent risk	New risk for this year	The Council has upgraded the Oracle General Ledger system to the Oracle Cloud in December 2018. We will therefore be required to perform a transfer of data audit to ensure that the financial statements are based on a complete set of transactions for the year.
Arrangements for taking informed decisions	Value for Money	New focus for this year	In the period from 1 April 2018 to date the most significant transaction undertaken by the Council was the transfer of trade and activities from the Arch Group to Advance Northumberland. We will consider the governance processes and procedures put in place by the Council to address this matter to determine whether appropriate arrangements are in place to take informed decisions.

Materiality



Overview of our 2018/19 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 the Council give a true and fair view of the financial position as at 31 March 2019 and of the income and expenditure for the year then ended; and
- ▶ Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

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

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

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

- ▶ Strategic, operational and financial risks relevant to the financial statements.
- ▶ Developments in financial reporting and auditing standards.
- ▶ The quality of systems and processes.
- ▶ Changes in the business and regulatory environment.
- ▶ 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



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>The Council has achieved a surplus outturn position for the last number of years and is forecasting a small underspend against budget for 2018/19. As the financial position of the Council is expected to become more challenging in future years we have assessed our risk as relating to the understatement of revenue and overstatement of expenditure.</p> <p>In particular, we will consider whether deferrals of income are appropriate and whether expenditure estimates that require a level of judgement such as provisions and accruals are fairly stated.</p>	<p>We will:</p> <ul style="list-style-type: none">▶ Sample test deferred income balances to check that deferrals are appropriate in line with the agreed terms and condition of the funding;▶ Review and discuss with management significant accounting estimates on expenditure recognition for evidence of bias; and▶ Review and test expenditure cut-off around 31 March 2019.
<p>Financial statement impact</p> <p>Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. These accounts had the following balances in the 2017/18 financial statements:</p> <p>Income Account: £899.5 million</p> <p>Expenditure Account: £893.5 million</p>		

Our response to significant risks (continued)

	What is the risk?	What will we do?
Risk of fraud and error*	<p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>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 otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>We will:</p> <ul style="list-style-type: none">▶ Identify fraud risks during the planning stages.▶ Inquire of management about risks of fraud and the controls put in place to address those risks.▶ Understand the oversight given by those charged with governance of management's processes over fraud.▶ Consider the effectiveness of management's controls designed to address the risk of fraud.▶ Determine an appropriate strategy to address those identified risks of fraud.▶ Perform mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements.

Our response to significant risks (continued)

<p>Valuation of land and buildings and Investment Property</p>	<p>What is the risk?</p>	<p>What will we do?</p>
<p>Financial statement impact</p> <p>Misstatements that occur in relation to the valuation of land and buildings affect the statement of financial position.</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 judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. We also note that the Council has engaged a new valuer to perform the valuation exercise this year which could lead to changes in some of the judgements and assumptions used.</p> <p>We also note that Advance Northumberland holds material values of investment property, including commercial properties, which are consolidated into the Group accounts. For this reason, we extend this risk to cover the land, buildings and investment property held by Advance Northumberland</p>	<p>We will:</p> <ul style="list-style-type: none"> ▶ Consider the work performed by the Council's valuer, 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 valuer in performing their valuation (e.g. floor plans to support valuations based on price per square metre). We will use EY Real Estate to support us in challenging the valuation where we do not have the expertise within the audit team. ▶ Consider the annual cycle of valuations to ensure that assets have been valued as part of a five-year rolling programme as required by CIPFA. ▶ Review assets not subject to valuation in 2018/19 to satisfy ourselves that the remaining asset base is not materially misstated. ▶ Consider changes to useful economic lives as a result of the most recent valuation. ▶ Request the Advance Northumberland audit team to perform procedures on the valuation of land and buildings and investment properties held in the subsidiary company. ▶ Test that the accounting entries have been correctly processed in the financial statements.

Audit risks

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?

Pension Liability Valuation

The Council's local government pension scheme liability is a material estimate on the Council's balance sheet. At 31 March 2018 the total value of the liability was £708 million.

Calculation of the liability involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. A small movement in the assumptions can have a material impact on the value of the liability and auditing standards require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

Changes to Group structure

The trade and activities of the Arch Group were transferred to Advance Northumberland, a new wholly owned subsidiary company of the Council in November 2018. There will be some complex accounting in the subsidiary entities to account for the transaction which will be significant for the Council's group financial statements.

What will we do?

We will:

- ▶ Liaise with the audit team of the Northumberland Pension Fund, to obtain assurances over the information supplied to the actuary for calculating the Council's pension liability.
- ▶ 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 PSAA for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team.
- ▶ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to the pensions disclosures.

We will:

- ▶ Discuss with management the progress undertaken to transfer the activities and review any Council and other legal papers to confirm the status of the companies at the year end.
- ▶ Consider whether the transfer and future plans for Advance Northumberland have any impact on the valuation of the assets and liabilities held in the Group balance sheet.
- ▶ Review the disclosures in the financial statements to ensure that they accurately reflect the transaction undertaken and the latest position of the new group structure.

Audit risks

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?

IFRS 9 financial instruments

This new accounting standard is applicable for local authority financial statements from the 2018/19 financial year and will change:

- ▶ How financial assets are classified and measured;
- ▶ How the impairment of financial assets are calculated; and
- ▶ The disclosure requirements for financial assets.

There are transitional arrangements within the standard; and the 2018/19 CIPFA Code of Practice on Local Authority accounting provides guidance on the application of IFRS 9 which will need to be applied

IFRS 15 Revenue from contracts with customers

This new accounting standard is applicable for local authority financial statements from the 2018/19 financial year.

The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.

The 2018/19 CIPFA Code of Practice on Local Authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of revenue and how they should be recognised.

The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue will change and new disclosure requirements introduced.

What will we do?

We will:

- ▶ Assess the Council's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19.
- ▶ Consider the classification and valuation of financial instrument assets.
- ▶ Review new expected credit loss model impairment calculations for assets.
- ▶ Review compliance with the new additional disclosure requirements.

We will:

- ▶ Assess the Council's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19. This will include Arch and Advance Northumberland consolidated into the Council's group financial statements;
- ▶ Consider application to the Council's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and
- ▶ Review compliance with the new additional disclosure requirements.

Audit risks

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
<p>General Ledger Upgrade</p> <p>The Council has upgraded the Oracle General Ledger system to the Oracle Cloud in December 2018. We will therefore be required to perform a transfer of data audit to ensure that the financial statements are based on a complete set of transactions for the year.</p>	<p>We will:</p> <ul style="list-style-type: none">▶ Review work performed by management and internal audit to obtain assurance over the completeness of the data transfer;▶ Review and test the reconciliations performed between systems as part of the data transfer; and▶ Liaise with our IT audit colleagues to support us in obtaining assurance that data transferred between systems is complete and accurate.



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 2018/19 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.

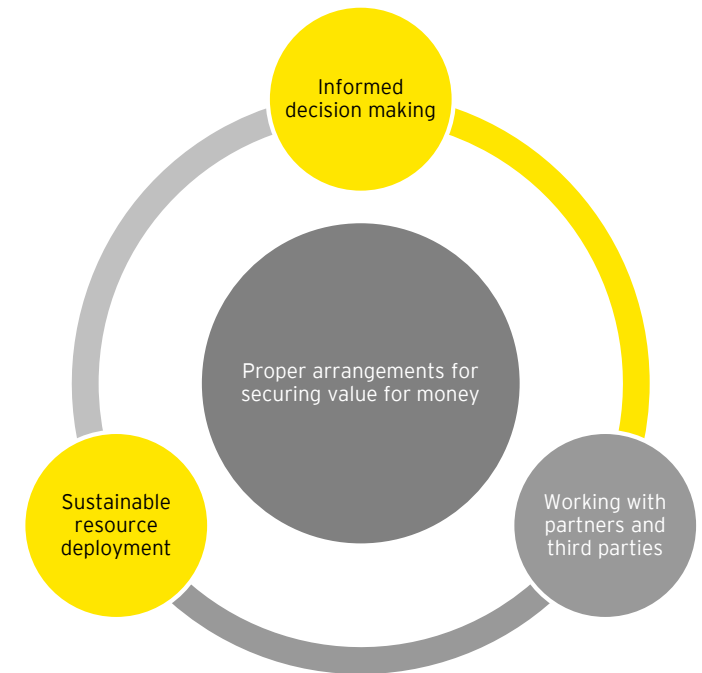
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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

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

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2018/19 this has included consideration of the steps taken by the Council to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that authorities will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

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 risks noted on the following page which we view as relevant to our value for money conclusion.





Value for money risks (continued)

Arrangements in place for taking informed decisions

What is the risk?

In the period from 1 April 2018 to date the most significant transaction undertaken by the Council has been the transfer of trade and activities from the Arch Group to Advance Northumberland.

We will review the information provided to key Committees on this transaction and the governance processes surrounding the transaction to determine whether appropriate arrangements were in place for taking an informed decision on this matter.

We will also follow up on the modification to our Value for Money conclusion in 2017/18 to consider whether appropriate processes and controls to address the issue are in place.

What will we do?

Our approach will focus on:

- ▶ Discussing with management the process undertaken for approval of actions taken in relation to these events.
- ▶ Reviewing relevant documentation from Council and Cabinet meetings alongside any external advice received in relation to each matter.
- ▶ Considering whether the governance process in place followed the policies and procedures established by the Council.



04

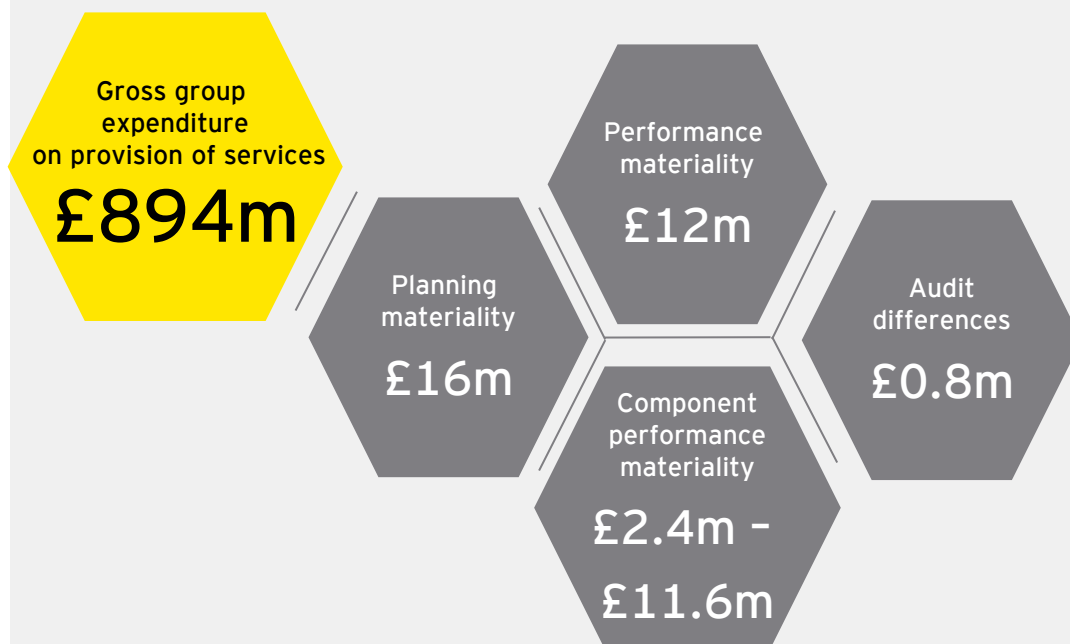
Audit materiality



Materiality

Materiality

For planning purposes, group materiality for 2018/19 has been set at £16 million. This represents 2% of the Council's group prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix D.



We request that the Audit 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 £12 million which represents 75% of planning materiality. We have used a threshold of 75% as we have identified limited audit adjustments in previous years.

Component performance materiality range - we determine component performance materiality as a percentage of Group performance materiality based on risk and relative size to the Group. Component materiality for the Council single entity financial statements is £11.6 million and for the Arch and Advance Northumberland is £2.4 million.

Audit difference threshold - we propose that misstatements identified below this threshold are deemed clearly trivial. The same threshold for misstatements is used for component reporting. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, housing revenue account, collection fund and firefighters' pension fund financial statements 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.



05

Scope of our audit



Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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

We issue an audit report that covers:

1. Financial statement audit

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

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

Procedures required by standards

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

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

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

For 2018/19 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.
- ▶ 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 the Chief Internal Auditor, and 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 our responsibilities.

Scoping the group audit

Group scoping

Our audit strategy for performing an audit of an entity with multiple components is risk based. We identify components as:

- 1. Significant components:** A component is significant when it is likely to include risks of material misstatement of the group financial statements, either because of its relative financial size to the group (quantitative criteria), or because of its specific nature or circumstances (qualitative criteria). We generally assign significant components a full or specific scope given their importance to the financial statements.
- 2. Not significant components:** The number of additional components and extent of procedures performed depended primarily on: evidence from significant components, the effectiveness of group wide controls and the results of analytical procedures.

For all other components we perform other procedures to confirm that there is no risk of material misstatement within those locations. These procedures are detailed below.

Scoping by Entity

Our preliminary audit scopes we have adopted are set out below. Note that these scopes are only for the purpose of the consolidated financial statements, separate statutory opinions will also be issued for all Group entities.

Council	Full scope audit
Arch	Specific scope audit
Advance Northumberland	Specific scope audit

As the trade and activity of Arch transferred to Advance Northumberland in November 2018, we have included the new company in our scope for 2018/19.

Scope definitions

Full scope: locations where a full audit is performed to the materiality levels assigned by the Group audit team for purposes of the consolidated audit.

Specific scope: locations where the audit is limited to specific accounts or disclosures identified by the group audit team based on the size and/or risk profile of those financial statements. For the audit of Arch and Advance Northumberland, our initial planning procedures have identified the following accounts as material to the group financial statements:

- ▶ Gross income
- ▶ Gross expenditure
- ▶ Property Plant and Equipment
- ▶ Investment Property
- ▶ Borrowings

Group audit team involvement in component audits

Auditing standards require us to be involved in the work of our component teams. We will liaise closely with our colleagues auditing Arch and Advance Northumberland to review their working papers where required to support our work on the group audit opinion.



06

Audit team



Audit team

Audit team

The engagement team is led by Stephen Reid who will have responsibility for ensuring that our audit delivers high quality and value to the Council. He will be supported by Caroline Mulley, the associate partner that leads the audit of the Arch and Advance Northumberland for matters that impact the Group financial statements.

Claire Mellons will be the senior manager responsible for the day-to-day direction of audit work and is the key point of contact for the finance team.

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

Area	Specialists
Valuation of Land and Buildings	BNP Paribas (Management's valuation specialists) EY Valuations Team
Pensions disclosure	AON Hewitt (Management's actuarial specialists) 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.
- ▶ 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 2018/19.

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
Risk assessment and setting of scopes. Walkthrough of key systems and processes	December		
	January	Audit Committee	Audit Planning Report
Interim audit testing Value for Money work	February		
	March	Audit Committee	Interim audit update
Interim top up testing	April		
	May	Audit Committee	Interim audit update
Year end audit work	June		
Completion and reporting	July	Audit Committee	Audit Results Report Audit opinions and completion certificates



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
<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 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 	<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 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 partner and the audit engagement team have not been compromised.

Self interest threats

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

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

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

At the time of writing, the current ratio of non-audit fees to audit fees is approximately 6%. 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 2018

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 1 July 2018 and can be found here:

<https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018>



09

Appendices



Appendix A

Fees

Our audit fees are set out in the table below. For 2018/19 the fees are in line with our engagement contract signed in December 2017 whereas the 2017/18 fees were based on the scale fees set by the Public Sector Appointments Agency Limited who appointed us as auditor for that year

	Fee 2018/19	Final Fee 2017/18
	£	£
Total Fee - Code work	119,800*	197,612
Total Fee - Housing Benefit certification work	6,550	9,341
Total Audit fee	126,350	206,953
Non-audit work - Other certification work	4,925	15,000
Non-audit work - Tax advice	0	15,975
Total other non-audit services	4,925	30,975
Total fees	131,275	237,928

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

* The fee in the table above is the base audit fee that was agreed in our engagement contract agreed in December 2017; however there are a number of one-off transactions in 2018/19 including the transfer of trade and activities from Arch to Advance Northumberland, the upgrade of the General Ledger, the implementation of new accounting standards and follow up of our modified VfM conclusion from 2017/18. Our initial calculations, based on the day rates agreed in the engagement contract, suggest that this may be in the region of £14,300.





We also note that there are other potential one-off factors such as the valuation of the shares held in Newcastle Airport and the change in accounting treatment of Kyloe House for which there may be a fee implication; however we do not have enough information about these transactions at the time of writing this report to estimate the fee implications.

We will agree all variations to the base fee with management as we progress through the audit before confirming the final amount and reporting to the Audit Committee.

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 signed December 2017
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	Engagement contract signed December 2017
Planning and audit approach	<p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p> <p>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</p>	Audit planning report
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





Appendix C

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
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
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
Related parties	<ul style="list-style-type: none"> ▶ Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the entity 	Audit results report



Appendix C

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 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 	Audit Planning Report and Audit Results Report
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
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
Internal controls	<ul style="list-style-type: none"> ▶ Significant deficiencies in internal controls identified during the audit 	Management letter/Audit results report

Appendix C

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	 What is reported?	 When and where
Group audits	<ul style="list-style-type: none"> ▶ 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 planning report Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	<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
Fee Reporting	<ul style="list-style-type: none"> ▶ Breakdown of fee information when the audit plan is agreed ▶ Breakdown of fee information at the completion of the audit ▶ Any non-audit work 	Audit planning report Audit results report
Certification work	Summary of certification work undertaken	Certification report

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 Group and 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 Group 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 Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- ▶ Maintaining auditor independence.



Appendix D

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 Group 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.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

© 2019 Ernst & Young LLP. Published in the UK.
All Rights Reserved.

ey.com