Item No. 11

Audit Strategy Memorandum

Sunderland City Council

Year ending 31 March 2020

MAZARS

CONTENTS

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Audit and Governance Committee Members
Sunderland City Council
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Sunderland
SR2 7DN

8 July 2020

Dear Members

Audit Strategy Memorandum – year ending 31 March 2020

We are pleased to present our Audit Strategy Memorandum for Sunderland City Council for the year ending 31 March 2020.

At the time of preparing this strategy, the current environment is undergoing unprecedented change; therefore, there may be further changes which we will communicate to you in due course. This strategy should be read in conjunction with our audit progress report which sets out our client commitment to you and how we will work with you in this time of significant change.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. As it is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, Section 7 of this document also summarises our considerations and conclusions on our independence as auditors.

We consider two-way communication with you to be key to a successful audit and important in:

- reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- sharing information to assist each of us to fulfil our respective responsibilities;
- providing you with constructive observations arising from the audit process; and
- ensuring that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks facing Sunderland City Council which may affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

This document, which has been prepared following our initial planning discussions with management, is the basis for discussion of our audit approach, and any questions or input you may have on our approach or role as auditor.

This document also contains specific appendices that outline our key communications with you during the course of the audit, and forthcoming accounting issues and other issues that may be of interest.

Client service is extremely important to us and we strive to continuously provide technical excellence with the highest level of service quality, together with continuous improvement to exceed your expectations so, if you have any concerns or comments about this document or audit approach, please contact me on 07813 752 053.

Yours faithfully

CWWaddell

Cameron Waddell
Key Audit Partner
For and on behalf of Mazars LLP

MAZARS

1. ENGAGEMENT AND RESPONSIBILITIES SUMMARY

Overview of engagement

We are appointed to perform the external audit of Sunderland City Council (the Council) for the year to 31 March 2020. The scope of our engagement is set out in the Statement of Responsibilities of Auditors and Audited Bodies, issued by Public Sector Audit Appointments Ltd (PSAA) available from the PSAA website: https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/

Our responsibilities

Our responsibilities are principally derived from the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (NAO), as outlined below.

Audit opinion

We are responsible for forming and expressing an opinion on the financial statements.
Our audit is planned and performed so to provide reasonable assurance that the financial statements are free from material error and give a true and fair view of the financial performance and position of the Council for the year.

Value for money

We are required to conclude whether the Council has proper arrangements in place to secure economy, efficiency and effectiveness in it its use of resources. We discuss our approach in section 5 of this report.

Reporting to the NAO

We report to the NAO on the consistency of the Council's financial statements with its Whole of Government Accounts (WGA) submission.

Electors' rights

The 2014 Act requires us to give an elector, or any representative of the elector, the opportunity to question us about the accounting records of the Council and consider any objection made to the accounts. We also have a broad range of reporting responsibilities and powers that are unique to the audit of local authorities in the United Kingdom.

Our audit does not relieve management, as those charged with governance, of their responsibilities. The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK), we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. However our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

The Council is required to prepare its financial statements on a going concern basis by the Code of Practice on Local Authority Accounting. As auditors, we are required to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements and the adequacy of disclosures made.

For the purpose of our audit, we have identified the Audit and Governance Committee as those charged with governance.

2. YOUR AUDIT ENGAGEMENT TEAM

- **Cameron Waddell, Partner and Audit Engagement Lead**
- E: cameron.waddell@mazars.co.uk
- M: 0781 375 2053

- **Diane Harold, Senior Manager**
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- **Ian Rutter, Assistant Manager**
- E: ian.rutter@mazars.co.uk
- M: 07881 283347

In addition, an engagement quality control reviewer (EQCR) has been appointed for this engagement.

3. AUDIT SCOPE, APPROACH AND TIMELINE

Audit scope

Our audit approach is designed to provide an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards on Auditing (UK), relevant ethical and professional standards, our own audit approach and in accordance with the terms of our engagement. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement, such as those affected by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

Audit approach

Our audit approach is risk-based and primarily driven by the issues that lead to a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment, we develop our audit strategy and design audit procedures in response to this assessment.

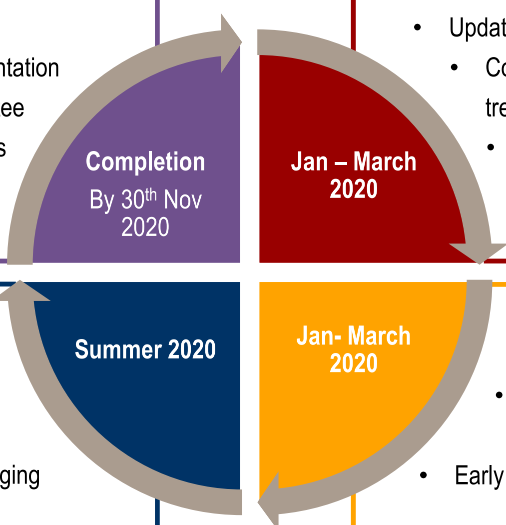
If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing. Substantive procedures are audit procedures designed to detect material misstatements at the assertion level and comprise tests of details (of classes of transactions, account balances, and disclosures) and substantive analytical procedures. Irrespective of the assessed risks of material misstatement, which take into account our evaluation of the operating effectiveness of controls, we are required to design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. The concept of materiality and how we define a misstatement is explained in more detail in section 8.

The diagram below outlines the procedures we perform at the different stages of the audit.

- Final review and disclosure checklist of financial statements
- Final partner and EQCR review
- Agreeing content of letter of representation
- Reporting to Audit & Governance Cttee
- Reviewing post balance sheet events
- Signing our opinion

- Initial opinion and value for money risk assessments
- Updating our understanding of the Council
- Considering proposed accounting treatments and accounting policies
- Development of our audit strategy
- Agreement of timetables
- Preliminary analytical procedures



- Review of draft financial statements
- Reassessment of audit strategy, revising as necessary
- Delivering our planned audit testing
- Continuous communication on emerging issues
- Clearance meeting

- Documenting systems and controls
- Walkthrough procedures
- Controls testing, including general IT controls
- Early substantive testing of transactions

3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Public interest entities

Some types of audits require additional considerations, such as public interest entities (PIEs). PIEs are those bodies as defined by the Financial Reporting Council's Ethical Standard, including those holding listed debt. As this Council holds a very small amount of debt (less than our triviality level set out in this document) listed on the London Stock Exchange, it is classed as a public interest entity. This results in:

- additional acceptance and engagement considerations;
- enhanced quality control requirements; and
- additional enhanced audit report requirements.

Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

Management's and our experts

Management makes use of experts in specific areas when preparing the financial statements. We also use experts to assist us to obtain sufficient appropriate audit evidence on specific items of account.

Items of account	Management's expert	Our expert
Defined benefit liability	AON Hewitt (Actuary)	We use the National Audit Office's (NAO) consulting actuary (PWC) to provide us with assurance over the main assumptions used by your Actuary.
Property, plant and equipment	In-house Valuer	We will take into account relevant information which is available from third parties. We have also commissioned a report from an external valuer (Cluttons).
Financial instrument disclosures	Link Asset Services	We do not typically engage an audit expert to assess the reasonableness for your expert's financial instrument valuation estimates. Where this is required we will engage our own internal experts.
Waste Private Finance Initiative (PFI) facility	Lambert Smith Hampton	We will commission work from our own expert, given the valuation of the waste facility is a specialised area.

Service organisations

International Auditing Standards define service organisations as third party organisations that provide services to the Council that are part of its information systems relevant to financial reporting. We are required to obtain an understanding of the services provided by service organisations as well as evaluating the design and implementation of controls over those services.

There are no material service organisations to consider for this Council.

3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Group audit approach

In line with the requirements of the CIPFA Code of Practice, the Council has considered its interests in other entities and determined that group accounts are required which will consolidate its interests. This section sets out the planned work in respect of those entities which we refer to here as components.

Component	Nature of component / ownership	Auditor
Sunderland City Council	***Parent – local authority.***	***Mazars LLP***
Together for Children Limited (TfC)	Subsidiary 100% owned by the Council for the provision of children's services.	Robson Laidler LLP
Sunderland Care and Support Limited (SCAS)	Subsidiary 100% owned by the Council for the provision of social care, health and support services.	Robson Laidler LLP
Sunderland Homes Limited	Subsidiary 100% owned by the Council for the development of building projects. Exempt from audit due to size.	Robson Laidler LLP
Siglion LLP – developments and investment companies	Subsidiary 100% owned by the Council, set up for: • development of land in Sunderland; and • management of a portfolio of commercial and residential land in Sunderland.	Robson Laidler LLP
IAMP LLP	Joint venture with South Tyneside Metropolitan Borough Council for the development of an international advanced manufacturing park (IAMP).	Robson Laidler LLP
Sunderland Lifestyle Partnership LLP	Joint venture with Sports and Leisure Management Limited for the provision of leisure facilities in Sunderland.	RSM LLP

Group materiality

Our assessment of group materiality is set out in section 8.

3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Group audit approach (continued)

We assess the significance of the components as part of determining the level of work required. In assessing the significance of components, we consider a range of quantitative and qualitative factors including:

- whether any component exceeds a minimum of 15% of key benchmarks (income, expenditure, assets and liabilities);
- whether any financial statement area (FSA) is greater than 15% of the relevant FSA in the consolidated accounts *and* greater than performance materiality: such components are classed as 'material but not significant' components; they are treated as if they were significant components and subject to a group audit; and
- whether there are any risks of material misstatement in the components likely to result in material misstatement in the group financial statements.

Our assessment is summarised in the table below: overall we have assessed there is one significant component: Together for Children. One component has been classed as 'material but not significant'; being the leisure joint venture, Sunderland Lifestyle Partnership.

Consolidation of two subsidiaries results in material balances relevant to the pensions and PPE significant risks already identified, for which assurance will be sought (SCAS and Siglion) at the group level, over and above group analytical procedures. The nature and scope of work is set out overleaf.

Component	Significant in terms of benchmarks?	Risks of material misstatement?	Commentary
The Council	**Yes**	**Yes**	**Being the ultimate parent.**
Together for Children	Yes	No	Material transactions and balances; income and expenditure is borderline with our 15% benchmark, therefore classed as a significant component. Pensions liability balance upon consolidation is greater than the group headline materiality and is relevant to the significant pensions risk already identified.
Sunderland Care and Support	No	No	Material transactions and balances; none greater than the benchmarks upon consolidation on a line by line basis.
Sunderland Homes	No	No	No transactions or balances expected to be greater than the benchmarks upon consolidation on a line by line basis.
Siglion	No	No	Material transactions and balances; none greater than the benchmarks upon consolidation on an equity basis. Property, Plant and Equipment balance upon consolidation is greater than the group headline materiality and is relevant to the PPE significant risk already identified.
IAMP	No	No	Provisional assessment based on expectations for 2019/20, that no transactions or balances will be greater than the benchmarks upon consolidation on an equity basis.
Sunderland Lifestyle Partnership	Yes	No	Material Financial Statement Areas (Revaluation Reserve and impact on Income Statement) due to accounting adjustment upon consolidation, as the leisure assets are valued at historic cost under FRS102 which differs to the valuation on the Council's balance sheet. Classed as a 'material but not significant' component and therefore subject to a group audit scope consistent with a significant component.

3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Group audit approach (continued)

Nature and scope of planned work

The table overleaf sets out the estimated proportion of each component, relative to the overall group, as well as the nature and scope of planned work. Note that these are estimates and we will update our assessment for any significant changes. This work is in addition to our review of group-wide controls and the consolidation process.

Nature of work

Planned procedures are split into the following categories:

- full scope audit;
- limited or specific review; and
- other audit procedures, including group analytical procedures.

Components being treated as 'significant' and subject to a full scope audit or specific audit procedures are:

- Together for Children (TfC);
- SLP (leisure assets); and
- the Council.

Group analytical procedures will be carried out for the remaining components, with additional procedures at the group level in respect of:

- the TfC and SCAS pensions liability; and
- Siglion property, plant and equipment.

The objective of the analytical procedures is to critically corroborate the group engagement team's conclusions that there are no significant risks of material misstatement of the aggregated financial information of components that are not significant components.

3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Group audit approach (continued) – using draft 2019/20 financial statements balances and transactions

Component	% of assets	% of liabilities	% of income	% of expenditure	Nature of work	Scope of work
The Council	94.8%	89.9%	78.0%	78.5%	Full scope audit	
TfC	1.0%	4.2%*	14.2%	13.7%	Full scope audit	*see note 1.
SCAS	0.7%	2.6%*	5.3%	5.0%	Group analytical procedures	*see note 2.
Siglion	3.3%*	2.2%	1.0%	1.2%	Group analytical procedures	*see note 3.
Sunderland Homes Limited	0.0%	0.0%	0.0%	0.0%	Group analytical procedures	Exemption from audit due to size. Shown as nil as percentages rounded to one decimal point.
IAMP (joint venture)	0.0%	0.9%	1.4%	1.4%	Group analytical procedures	Joint venture, therefore consolidated on an equity basis.
Sunderland Lifestyle Partnership (SLP – joint venture)	0.2%	0.2%	0.1%*	0.2%	Specified audit procedures in respect of the leisure assets	SLP assessed as a material but not significant component: therefore, subject to a group audit scope consistent with a significant component. *see note 4.
	100%	**100%**	**100%**	**100%**		

Notes

1. **Together for Children (TfC):** pensions liability – as per approach for SCAS below.
2. **Sunderland Care and Support (SCAS):** additional procedures at the group level in respect of the pensions liability: not material in terms of the benchmarks, however, relevant to the group significant risk. Work will include critical review of the Actuary's report.
3. **Siglion:** additional procedures at the group level in respect of property, plant and equipment; not material in terms of the benchmarks, however, relevant to the group significant risk. Work will include critical review of management's adjustments, to account for the December year-end versus the Council's March year-end.
4. **Sunderland Lifestyle Partnership:** 'material' due to the accounting adjustment of the leisure assets upon consolidation, therefore no assurance required from the component auditor. Assessment of 'material financial statement areas' for:

   - Revaluation Reserve; and
   - Surplus / deficit on revaluation of non-current assets.

5. SIGNIFICANT RISKS, KEY AUDIT MATTERS AND OTHER JUDGEMENTS AND ENHANCED RISKS

Following the risk assessment approach discussed in section 3 of this document, we have identified relevant risks to the audit of financial statements. The risks that we identify are categorised as significant, enhanced or standard, as defined below:

Significant risk A significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. For any significant risk, the auditor shall obtain an understanding of the entity's controls, including control activities relevant to that risk.

Enhanced risk An enhanced risk is an area of higher assessed risk of material misstatement at audit assertion level other than a significant risk. Enhanced risks incorporate but may not be limited to:

- key areas of management judgement, including accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement; and
- other audit assertion risks arising from significant events or transactions that occurred during the period.

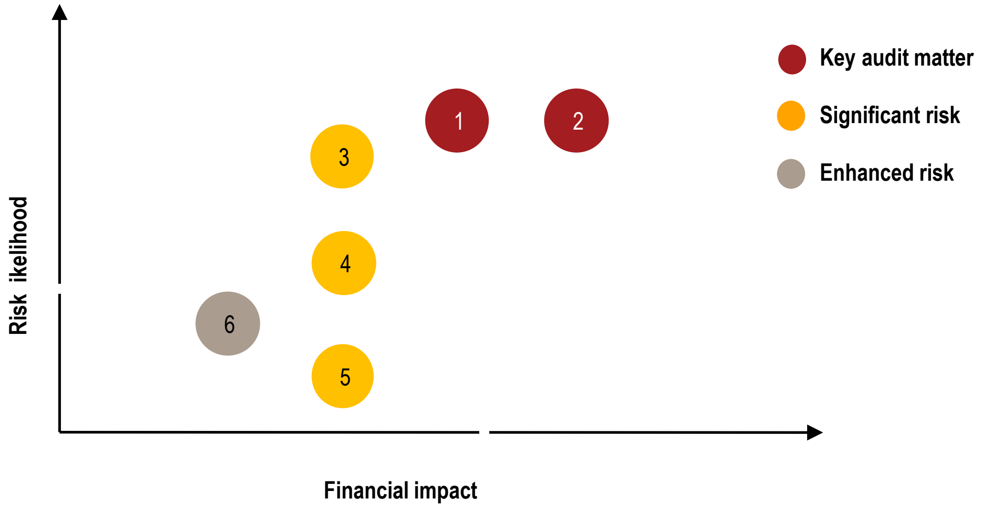
Standard risk This is related to relatively routine, non-complex transactions that tend to be subject to systematic processing and require little management judgement. Although it is considered that there is a risk of material misstatement, there are no elevated or special factors related to the nature, the likely magnitude of the potential misstatements or the likelihood of the risk occurring.

Key audit matters

Key audit matters are defined as those matters that, in our professional judgment, are of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we have identified, including those which have the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

5. SIGNIFICANT RISKS, KEY AUDIT MATTERS AND OTHER JUDGEMENTS AND ENHANCED RISKS (CONTINUED)

It is important that you understand and have opportunity to discuss with us why something is being communicated as a key audit matter and the way this is described. The summary risk assessment, illustrated in the audit risk continuum below, highlights those risks which we deem to be significant, key audit matters and other enhanced risks. Our audit response to each of these risks in the following section.



	Significant, key audit matters (KAM) and enhanced risks
1	Significant: property, plant and equipment and investment properties valuations (KAM)
2	Significant: defined benefit liability valuation (KAM)
3	Significant: management override of controls
4	Significant: revenue recognition: fees charges and other income
5	Significant: valuation of long and short-term debtors
6	Enhanced: valuation of the Airport shares (long-term investments)

Group risks

The risks shown above and further detailed in the tables overleaf are in respect of the single entity, ie the Council. They also are in respect of the group, given that the group financial statements contain those of the single entity.

We have assessed whether there are any specific significant risks likely for the components which might result in material misstatement of the group financial statements; our assessment at the planning stage is that overall, there are no such specific risks in relation to the components.

5. SIGNIFICANT RISKS, KEY AUDIT MATTERS AND OTHER JUDGEMENTS AND ENHANCED RISKS (CONTINUED)

We provide more detail on the identified risks and our testing approach with respect to significant risks in the table below. An audit is a dynamic process, should we change our view of risk or approach to address the identified risks during the course of our audit, we will report this to the Audit and Governance Committee.

	Description of risk	Fraud	Error	Judgement	Expected KAM	Planned response
1	**Significant risk: property, plant and equipment and investment property valuations** The financial statements contain material entries on the balance sheet as well as material disclosure notes in relation to the Council's holding of property, plant and equipment and investment properties (including the Council's PFI shared waste facility) The Council employs a valuation expert to provide information on valuations, however there remains a high degree of estimation uncertainty associated with the (re)valuations of property, plant and equipment and investment properties due to the significant judgements and number of variables involved. The risk has increased as a result of the economic downturn arising from COVID-19. We note also the Valuation Practice Alert issued by the valuation body The Royal Institute of Chartered Surveyors (RICS) recently. This highlighted the use by Valuers, where appropriate, of material uncertainty declarations in their valuation reports.					We will: • critically assess the Council's arrangements for ensuring that property, plant and equipment and investment property valuations are reasonable; • critically assess the basis of valuations, using third party trend data where appropriate, as part of our challenge of the reasonableness of the valuations provided by Valuer(s), including the PFI shared waste facility; • consider the competence, skills and experience of the Valuer(s) and the instructions issued to the Valuer(s); • substantively test capital expenditure additions and disposals during the year; • substantively test the Council's property, plant and equipment and investment properties to gain assurance that they exist and are owned by the Council; • substantively test revaluations, including critically reviewing the Council's own consideration of assets not revalued in the year and why they are not materially misstated; • carry out procedures to gain assurance over the consolidation adjustments for group accounts which impact on property, plant and equipment and associated financial statement areas; • critically consider any material uncertainties expressed by the Valuer(s) used by the Council and consider any implications on our audit work; and • where necessary, perform further audit procedures on individual assets to ensure the basis of valuations is appropriate.

5. SIGNIFICANT RISKS, KEY AUDIT MATTERS AND OTHER JUDGEMENTS AND ENHANCED RISKS (CONTINUED)

	Description of risk	Fraud	Error	Judgement	Expected KAM	Planned response
3	**Significant risk: defined benefit liability valuation** The financial statements contain material pension entries in respect of the retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement. The risk has increased as a result of the economic downturn arising from COVID-19.					We will: • critically evaluate the Council's arrangements (including relevant controls) for making estimates in relation to pension entries within the financial statements; and • challenge the reasonableness of the Actuary's assumptions that underpin the relevant entries made in the financial statements, through the use of an expert commissioned by the National Audit Office; • critically assess the competency, objectivity and independence of the Actuary; • liaise with the auditors of the Pension Fund to gain assurance that the controls in place at the Pension Fund are operating effectively; • compare assumptions to expected ranges, using information provided by the consulting actuary engaged by the National Audit Office; and • agree data in the Actuary's valuation report for accounting purposes to the relevant accounting entries and disclosures in the Council's financial statements.

5. SIGNIFICANT RISKS, KEY AUDIT MATTERS AND OTHER JUDGEMENTS AND ENHANCED RISKS (CONTINUED)

	Description of risk	Fraud	Error	Judgement	Expected KAM	Planned response
3	**Significant risk: management override of controls** Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.					We plan to address the management override of controls risk through performing audit work over accounting estimates, journal entries and significant transactions outside the normal course of business or otherwise unusual.
4	**Significant risk: risk of fraud in revenue recognition - fees, charges and other income** Our audit methodology incorporates this risk as a significant risk at all audits, although based on the circumstances of each audit, it is rebuttable. We have concluded that we can rebut the presumption of a revenue recognition risk for the majority of the Council's revenue streams, consisting largely of taxation, business rates and grant income. However, we do not feel that sufficient scope exists to rebut this risk in respect of the recognition of fees, charges and other income. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.					We will: • substantively test fees, charges and other income to ensure it has been correctly classified and recognised; • test journals; and • obtain direct confirmation of year-end bank balances and test the reconciliations to the ledger.
5	**Significant risk: valuation of short and long-term debtors** There is an increased risk that the valuation of debtors, both short and long-term, will be impacted by the economic downturn. The Council's long-term debtors includes loans to other bodies and Newcastle Airport. The Council also has provided for the potential impairment of short-term debtors which may be impacted by the economic downturn.					We will: • critically review the basis of valuation of short and long-term debtors, including the Council's assessment of expected credit losses (the latter including the Airport loans); • critically review the adequacy of the impairment of debtors allowance; • challenge the assumptions made by the Council, in particular in light of the economic downturn.

5. SIGNIFICANT RISKS, KEY AUDIT MATTERS AND OTHER JUDGEMENTS AND ENHANCED RISKS (CONTINUED)

	Description of risk	Fraud	Error	Judgement	Expected KAM	Planned response
6	**Enhanced risk: valuation of long-term investments (Airport shares and other investments)** The Council has to make judgements in respect of the fair value measurements of unquoted equity investments it holds, namely Newcastle Airport. The risk has increased as a result of the economic downturn arising from COVID-19.					We will: • assess the basis of valuation for the Council's shares in the Airport; • critically review the assumptions made by management; and • assess whether disclosures are in line with the Code of Audit Practice.

5. VALUE FOR MONEY CONCLUSION

Our approach

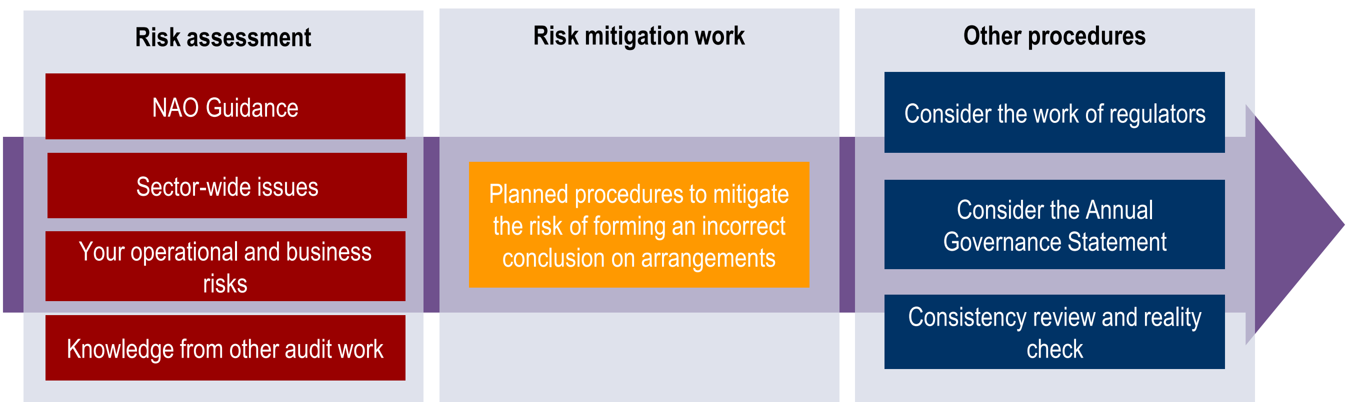
We are required to form a conclusion as to whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The National Audit Office (NAO) issues guidance to auditors that underpins the work we are required to carry out, and sets out the overall criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.'

To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria have been set out by the NAO:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

A summary of the work we undertake is provided below:



Significant audit risks

The NAO's guidance requires us to carry out work at the planning stage to identify whether or not a value for money (VFM) conclusion risk exists. Risk, in the context of our work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate. As outlined above, in carrying out our work we draw on our deep understanding of the Council and its partners, the local and national economy and wider knowledge of the public sector.

For the 2019/20 financial year, we have identified the following two significant risks, which are further detailed overleaf:

- responding to financial pressures; and
- Ofsted's inspection of children's services.

We would highlight that our risk assessment is a continuous process and we will revisit this during the year, right up until when the opinion is given, in particular in light of the economic downturn.

5. VALUE FOR MONEY CONCLUSION

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#	Description of significant VfM risk	Planned response
1	**Sustainable resource deployment – financial pressures** The Council faces financial pressures from reduced funding and continues to identify plans to deliver future savings and improvements, including alternative models of service delivery. Without robust budgetary control and delivery of its action plans, the Council's financial resilience and service performance could deteriorate.	We will review budget monitoring and reporting. We will also consider the adequacy of plans that are developed to deliver savings and improvements. We will also consider the latest update of the Council's medium-term financial strategy, as a result of the economic downturn arising from Covid-19.
2	**Ofsted inspection: children's services** There is a risk Council does not make the required improvements to children's services, or does not make the improvements rapidly enough. In July 2015, Ofsted reported the results of an inspection of services for children in need of help and protection, children looked after, care leavers and adoption performance. Ofsted concluded that these services and their leadership, management and governance were inadequate. Ofsted also concluded that the arrangements in place to evaluate the effectiveness of what is done by the Council and its partners to safeguard and promote the welfare of children, through the Sunderland Safeguarding Children Board, were inadequate. Our response to the conclusions reached by Ofsted, was to incorporate an 'except for' qualification into our VFM conclusions since 2014/15. Monitoring visits have taken place since then including a re-inspection in 2018.This showed that some aspects of children's services had improved however the categories of 'children who need help and protection' and 'leadership, management and governance' remained inadequate.	We will consider the progress made by the Council in relation to children's services at the point we give our VFM conclusion. This requires an expert judgement, and we will rely on the updated assessment of Ofsted in determining whether another 'except for' qualification is needed for the VFM conclusion or whether sufficient improvement has been made to avoid a further qualification.

6. FEES FOR AUDIT AND OTHER SERVICES

Fees for work as the Council's appointed auditor

At this stage of the audit we expect to need to reflect the scale fee set by PSAA as communicated in our fee letter of 17 April 2019 and other matters listed below:

Service	2018/19 fee	2019/20 fee
Code audit work – scale fee	£104,546	£104,546
Additional work to reflect the cost of audit work on the revised financial statements following a changes to pension liabilities to take account of the McCloud adjustment and other amendments	£6,048	n/a
Additional work to reflect the Council's designation as a Public Interest Entity	n/a	To be agreed
Additional work in response to regulatory recommendations to increase level of audit work on defined benefit liability schemes	n/a	To be agreed
Additional work in response to regulatory recommendations to increase level of audit work on the valuation of property plant and equipment	n/a	To be agreed
Total	**£110,594**	**To be agreed**

Additional work

In common with all local government external auditors we are required to carry out additional procedures which were not expected when fees were set.

Public interest Entity

Designation as an EU Public Interest Entity (EU PIE): the new European Union (EU) statutory audit legislation came into effect for all financial years starting on or after June 17, 2016. The new Public Interest Entity (PIE) definition includes organisations with transferable securities listed on EU regulated markets and governed by the law of an EU member. Sunderland City Council had £35,000 of listed debt as at 31 March 2019. As a result of this listed debt, the Council falls under the definition of an EU PIE. In particular there are additional requirements at both the planning and the reporting stages of the audit, culminating in the longer-form audit report.

Regulatory recommendations

We continually strive to maintain high standards of audit quality. One mechanism for doing this is to consider the outcome of independent quality reviews, in particular by the Financial Reporting Council, of our audit work and that of other audit suppliers. In particular we are planning increases in the level of work we do on:

- defined benefit pension schemes; and
- valuation of property, plant and equipment

We will discuss the driving factors with Council officers and the audit fee for 2019/20 will be revisited to reflect the increased level of work that was not considered when the scale fee was set. Any agreed additional fee is also subject to detailed scrutiny by the PSAA as part of the approval process.

6. FEES FOR AUDIT AND OTHER SERVICES

Fees for non-PSAA work

In addition to the fees outlined above in relation to our appointment by PSAA, we anticipate being engaged by the Council to carry out additional work as set out in the table below. Before agreeing to undertake any additional work we consider whether there are any actual, potential or perceived threats to our independence. Further information about our responsibilities in relation to independence is provided in section 7.

Service	2019/20 fee	2018/19 fee
Assurance work on Housing Benefit Subsidy	£9,500*	£9,210
Assurance work on the Teachers' Pension return	£4,000*	£3,920
Assurance work on Skills Funding Agency subcontracting arrangements	£3,650*	£3,600

*estimated fees, subject to agreement

7. OUR COMMITMENT TO INDEPENDENCE

We are committed to independence and are required by the Financial Reporting Council to confirm to you at least annually, in writing, that we comply with the Financial Reporting Council's Ethical Standard. In addition, we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

We have not made arrangements for any of our activities as auditor to be conducted by another firm that is not a Mazars' member firm. In section 4 we have outlined the experts that we intend to use as part of our audit. We will write to these experts seeking confirmation of their independence and will report this within our Audit Completion Report.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement there are no relationships between us and any of our related or subsidiary entities, and you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors. We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- all partners and staff are required to complete an annual independence declaration;
- all new partners and staff are required to complete an independence confirmation and also complete computer-based ethical training;
- rotation policies covering audit engagement partners and other key members of the audit team; and
- use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement partner.

Public interest entity specific requirements

In addition, there are specific requirements in respect of public interest entities, such as this Council, including in respect of:

- the prohibition on provision of certain non-audit services; and
- rotation periods.

Confirmation of independence

We confirm, as at the date of this document, that the engagement team and others in the firm as appropriate, and Mazars LLP are independent and comply with relevant ethical requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Cameron Waddell in the first instance. Prior to the provision of any non-audit services Cameron Waddell will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence. Included in this assessment is consideration of Auditor Guidance Note 01 as issued by the NAO, and the PSAA Terms of Appointment.

Any emerging independence threats and associated identified safeguards will be communicated in our Audit Completion Report. Principal threats to our independence and identified associated safeguards in relation to the non-audit work listed in section 6, are summarised below.

Area of work	Perceived threat	Safeguards and commentary
Assurance Services: Housing Benefits Subsidy return	Self-review threat	No safeguards required. The fee for this work is neither significant to Mazars LLP nor the Council/group.
Assurance Services: Skills Funding Agency - review of Subcontracting Arrangements	Self-review threat	No safeguards required. The fee for this work is neither significant to Mazars LLP nor the Council/group.
Assurance Services: Teachers' Pensions Return	Self-review threat	No safeguards required. The fee for this work is neither significant to Mazars LLP nor the Council/group.

8. MATERIALITY AND MISSTATEMENTS

Summary of materiality thresholds (based on draft financial statements)

Thresholds	Group materiality £000	Council single-entity materiality £000
Overall materiality	13,898	13,538
Performance materiality	10,840	10,560
Trivial threshold for errors to be reported to the Audit and Governance Committee	417	406

Materiality
Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality when planning and performing our audit using quantitative and qualitative factors.

At the planning stage we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures. The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage. Our materiality is set based on a benchmark of the 2019/20 gross expenditure at the surplus/deficit on the provision of services level per the draft financial statements. We have calculated a headline figure for materiality but have also identified separate levels for procedures designed to detect individual errors, and also a level above which all identified errors will be reported to the Audit and Governance Committee.

We consider that gross expenditure at the net cost of services level is the key focus of users of the financial statements and, as such, we base our materiality levels around this benchmark.

8. MATERIALITY AND MISSTATEMENTS (CONTINUED)

Overall materiality

We have set our materiality threshold at 2% of the benchmark based on the 2019/20 draft financial statements. We considered qualitative factors in making our assessment including:

- the level of understanding users of the financial statements have in respect of the inherent uncertainties and judgements made;
- the level of understanding users of the financial statements have that the statements being audited to levels of materiality; and
- our ability to make informed decisions about users' understanding of materiality.

Based on the 2019/20 draft financial statements we anticipate the overall materiality for the group to be £13.9m and the Council £13.5m (prior year final materiality was £13.9m and £13.3m for the group and Council respectively). After setting initial materiality, we continue to monitor materiality throughout the audit to ensure that it is set at an appropriate level.

Performance Materiality

Performance materiality is the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce, to an appropriately low level, the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. Our initial assessment of performance materiality is based on low inherent risk, meaning that we have applied 78% of overall materiality as performance materiality.

Specific materiality

We have also calculated materiality for specific classes of transactions, balances or disclosures where we determine that misstatements of a lesser amount than materiality for the financial statements as a whole, could reasonably be expected to influence the decisions of users taken on the basis of the financial statements. We have set specific materiality for the following items of account:

Item of account	Basis	Specific materiality
Officers' remuneration*	25% of total	£195,000
Officers' remuneration (bandings table)	Bandings (£5,000)	£5,000 banding
Members' allowances and expenses*	25% of total	£284,000
Exit packages (termination benefits)	25% of total	£302,000

* applicable to single entity only

Group materiality for components
In the context of a group audit, materiality is established for both the group financial statements as a whole and for the financial information of components. Component materiality is determined for those components whose financial information will be audited as part of the group audit.

- **Together for Children (TfC) component materiality:** calculated as £2.204 million, being 2% of total revenues. However, where a component is subject to audit itself, use can be made however of the component auditor's materiality, as long as it is lower than our calculated component materiality. This is the case for TfC, therefore we will make use of their auditor's calculation of materiality.

- **Sunderland Lifestyle Partnership component materiality:** as set out in the audit scope section, this component is being treated as a material but not significant component as a result of a material financial statement area for which we will obtain assurance via specific procedures on the accounting consolidation adjustment. Therefore we do not need to issue group audit instructions to this component or specifying component materiality.

8. MATERIALITY AND MISSTATEMENTS (CONTINUED)

Reporting misstatements threshold

We aggregate misstatements identified during the audit that are other than clearly trivial. We set a level of triviality for individual errors identified (a reporting threshold) for reporting to the Audit and Governance Committee that is consistent with the level of triviality that we consider would not need to be accumulated because we expect that the accumulation of such amounts would not have a material effect on the financial statements. Based on our preliminary assessment of overall materiality, our proposed triviality threshold is £404,000 for the group and £393,000 for the Council single-entity financial statements based on 3% of overall materiality.

Reporting to the Audit and Governance Committee

To comply with International Standards on Auditing (UK), the following three types of audit differences will be presented to the Audit and Governance Committee:

- summary of adjusted audit differences;
- summary of unadjusted audit differences; and
- summary of disclosure differences (adjusted and unadjusted).

APPENDIX A – KEY COMMUNICATION POINTS

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specifically require us to communicate the following:

Required communication	Where addressed
Our responsibilities in relation to the financial statements audit and those of management and those charged with governance.	Audit Strategy Memorandum
The planned scope and timing of the audit including any limitations, specifically including with respect to key audit matters.	Audit Strategy Memorandum
With respect to misstatements: • Uncorrected misstatements and their effect on our audit opinion; • The effect of uncorrected misstatements related to prior periods; • A request that any uncorrected misstatement is corrected; and • In writing, corrected misstatements that are significant.	Audit Completion Report
With respect to fraud communications: • Enquiries of the Audit and Governance Committee to determine whether they have a 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 fraud may exist; and • A discussion of any other matters related to fraud.	Audit Completion Report Discussion at Audit and Governance Committee Audit planning and clearance meetings
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; and • difficulty in identifying the party that ultimately controls the entity.	Audit Completion Report
Significant deficiencies in internal controls identified during the audit.	Audit Completion Report
Where relevant, any issues identified with respect to authority to obtain external confirmations or inability to obtain relevant and reliable audit evidence from other procedures.	Audit Completion Report
Indication of whether all requested explanations and documents were provided by the entity.	Audit Completion Report

APPENDIX A – KEY COMMUNICATION POINTS (CONTINUED)

Required communication	Where addressed
Significant findings from the audit including: • 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 or were the subject of correspondence with management; • written representations that we are seeking; • expected modifications to the audit report; and • other matters, if any, significant to the oversight of the financial reporting process or otherwise identified in the course of the audit that we believe will be relevant to the Those Charged with Governance or the Audit and Governance Committee in the context of fulfilling their responsibilities.	Audit Completion Report
Audit findings regarding non-compliance with laws and regulations where the non-compliance is material and believed to be intentional (subject to compliance with legislation on tipping off) and enquiry of the Audit and Governance 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 and Governance Committee may be aware of.	Audit Completion Report Audit and Governance Committee meetings
With respect to 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; and • the adequacy of related disclosures in the financial statements.	Audit Completion Report
Reporting on the valuation methods applied to the various items in the annual financial statements including any impact of changes of such methods.	Audit Completion Report
Explanation of the scope of consolidation and the exclusion criteria applied by the entity to the non-consolidated entities, if any, and whether those criteria applied are in accordance with the relevant financial reporting framework.	Audit Strategy Memorandum and/or Audit Completion Report as appropriate
Where applicable, identification of any audit work performed by component auditors in relation to the audit of the consolidated financial statements other than by Mazars' member firms.	Audit Strategy Memorandum and/or Audit Completion Report as appropriate
Identification of each key audit partner involved in the audit	Audit Strategy Memorandum
Communication in respect of any arrangements for any of our activities as auditor to be conducted by another firm.	Audit Strategy Memorandum and/or Audit Completion Report as appropriate

APPENDIX A – KEY COMMUNICATION POINTS (CONTINUED)

Required communication	Where addressed
Description of nature, frequency and extent of communication with the Audit and Governance Committee and other relevant bodies including dates of meetings	Audit Strategy Memorandum
Description of distribution of tasks among the auditors where more than one auditor has been appointed	Audit Strategy Memorandum
Description of methodology used, including which categories of the balance sheet have been directly verified and which categories have been verified based on system and compliance testing, including an explanation of any substantial variations compared to the previous year	Audit Strategy Memorandum and/or Audit Completion Report as appropriate
Disclosure of quantitative level of materiality applied to the audit, any specific materiality levels applied to particular classes of transactions, account balances or disclosures, and qualitative factors considered when setting materiality	Audit Strategy Memorandum and/or Audit Completion Report as appropriate
Explanation of judgements about events or conditions identified during the course of the audit that may cast significant doubt on the entity's ability to continue as a going concern and whether they constitute a material uncertainty, and provide a summary of all guarantees, comfort letters, undertakings of public intervention and other support measures that have been taken into account when making a going concern assessment	Audit Strategy Memorandum and/or Audit Completion Report as appropriate
Reporting on significant deficiencies including whether or not the deficiency in question has been resolved by management	Audit Completion Report

APPENDIX B – FORTHCOMING ACCOUNTING AND OTHER ISSUES

Financial reporting changes relevant to 2019/20

There are no significant changes in the Code of Practice on Local Authority Accounting for the 2019/20 financial year.

Financial reporting changes in future years

Accounting standard	Year of application	Commentary
IFRS 16 – Leases	2021/22 *In light of COVID-19 pressures, HM Treasury and the Financial Reporting Advisory Board (FRAB) have decided that IFRS 16 implementation in the public sector will be deferred for a further year, to 2021/22.*	The CIPFA/LASAAC Code Board has determined that the Code of Practice on Local Authority Accounting will adopt the principles of IFRS 16 Leases. IFRS 16 will replace the existing leasing standard, IAS 17, and will introduce significant changes to the way bodies account for leases, which will have substantial implications for the majority of public sector bodies. The most significant changes will be in respect of lessee accounting (i.e. where a body leases property or equipment from another entity). The existing distinction between operating and finance leases will be removed and instead, the new standard will require a right to use an asset, and the associated lease liability to be recognised on the lessee's Balance Sheet. In order to meet the requirements of IFRS 16, all local authorities will need to undertake a significant project that is likely to be time-consuming and potentially complex. There will also be consequential impacts upon capital financing arrangements at many authorities which will need to be identified and addressed at an early stage of the project.

APPENDIX C – EXTENDED AUDITOR'S REPORT

Basis of requirement for an extended auditor's report
We are required to issue an extended auditor's report on the Council's 2019/20 financial statements under ISA (UK) 700 'Forming an Opinion and Reporting on Financial Statements'. This is required as the Council meets the definition of a Public Interest Entity as a result of it having debt that is listed on an EU regulated market.

Layout of the extended auditor's report
The extended auditor's report for 2019/20 is expected to follow the format and structure outlined below, assuming that no emphasis of matter or qualification is required.

Paragraph heading	Summary of key content
Opinion	What we have audited and our opinion thereon.
Basis for opinion	Confirmation: • that the audit is undertaken under the ISAs (UK) • of our independence including with the FRC's Ethical Standard • regarding sufficiency and appropriateness of audit evidence obtained to provide a basis for our opinion.
Conclusions relating to going concern	Reporting by exception on the Council's: • use of the going concern basis of accounting • disclosure of any material uncertainties
Key audit matters	Definition of key audit matters. Clarification that these matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and that we do not provide a separate opinion on these matters. For each key audit matter identified: • a description of the most significant assessed risk(s) of material misstatement • a summary of our response to those risks • key observations arising with respect to those risks including clear reference to relevant disclosures in the financial statements, where relevant.
Our application of materiality	Explanation of how we applied the concept of materiality in planning and performing the group and parent company audit. The overall materiality threshold for the group and single entity financial statements as a whole.
An overview of the scope of our audit	Overview of the scope of the audit, including an explanation of how the scope addressed each key audit matter and was influenced by our application of materiality.
Other information	Responsibilities of the s151 officer and of the auditor for other information included in the Narrative Report.

APPENDIX C – EXTENDED AUDITOR'S REPORT

Paragraph heading	Summary of key content
Responsibilities of the s151 officer for the financial statements	Cross reference to the s151 officer responsibilities.
Auditor's responsibilities for the audit of the financial statements	Explanation of the 'reasonable assurance' objective of the audit Cross-reference to our responsibilities for the audit on the FRC's web-site
Matters on which we are required to report by exception	Report in the public interest under section 24 of the Local Audit and Accountability Act 2014. Recommendation under section 24 of the Local Audit and Accountability Act 2014. Exercise of any other special powers of the auditor under the Local Audit and Accountability Act 2014.
Value for Money arrangements conclusion	Our conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.
Basis for conclusion	Overview of the scope of our value for money work.
Responsibilities of the Council for arrangements for securing economy, efficiency and effectiveness in its use of resources	Sets out the Council's responsibilities.
Auditor's responsibilities in relation to review of arrangements for securing economy, efficiency and effectiveness in the use of resources	Sets out the auditor's responsibilities, derived from the Local Audit and Accountability Act 2014.
Other matters which we are required to address	Confirms that we have not carried out any prohibited non-audit services and that we remain independent on the Council and its group. Confirms that our audit opinion is consistent with the Audit Completion Report.
Use of the audit report	Sets out who we are reporting to and what the report may be used for.
Audit certificate	Sets out that we have completed the audit of the Council in accordance with the Local Audit and Accountability Act 2014.