



# Our accounts audit approach

## Introduction

This memorandum is intended to provide additional detail regarding our audit approach, as set out in our Audit Plan 2010/11 issued in February 2011, as well as an update on our response to key risks from the results of interim audit work carried out to date.

## Audit approach reminder

We will:

- work closely with the finance team to ensure that we meet audit deadlines and conduct the audit efficiently
- plan our audit on an individual task basis at the start of the audit, and agree timetables with all staff involved; and
- consider the materiality of transactions when planning our audit and when reporting our findings

**The logistical details of our annual accounts audit, as agreed with the Head of Finance, Performance and Asset Management, are detailed in Appendix A to this memorandum.**

In summary our audit strategy comprises:

<b>Planning</b>	<ul style="list-style-type: none"><li>• Updating our understanding of the Council through discussions with management and a review of the management accounts</li></ul>
<b>Control evaluation</b>	<ul style="list-style-type: none"><li>• Reviewing the design effectiveness and implementation of internal financial controls including IT, where they impact the financial statements</li><li>• Assessing audit risk and developing and implementing an appropriate audit strategy</li><li>• Testing the operating effectiveness of selected controls</li><li>• Assessing the effectiveness of internal audit against the CIPEA Code of Practice</li></ul>
<b>Substantive procedures</b>	<ul style="list-style-type: none"><li>• Reviewing material disclosure issues in the financial statements</li><li>• Performing analytical review</li><li>• Verifying all material income and expenditure and balance sheet accounts, taking into consideration whether audit evidence is sufficient and appropriate</li></ul>
<b>Completion</b>	<ul style="list-style-type: none"><li>• Performing overall evaluation</li><li>• Determining an audit opinion</li><li>• Reporting to Finance, Audit and Risk Committee</li></ul>

# Our accounts audit approach (continued)

## Materiality

An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true or fair view.

Materiality is set at the outset of planning to ensure that an appropriate level of audit work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences greater than 2% of materiality will be recorded on a schedule of potential misstatements.

These are assessed individually and in aggregate, discussed with you and, if you do not adjust, signed off by you in your letter of representation to us, confirming your view that they are immaterial to the financial statements.

An item of low value may be judged material by its nature, for example any item that affects the disclosure of directors' emoluments. An item of higher value may be judged not material if it does not distort the truth and fairness of the financial statements.

## Reliance on internal audit

We will work with the internal audit function to ensure our audit approach takes account of the risks identified and the work they have conducted, subject to our review of the effectiveness of the internal audit function.

## Review of IT and outsourced systems

Our audit approach assumes that our clients use a computer system for accounting applications that process a large number of transactions. Accordingly, our approach requires a review of the Council's internal controls in the information technology (IT) environment.

We have involved Technology Risk Services (TRS) team members during the audit, this was based on the complexity of IT used in the significant transaction cycles and the control risk assessment.

## Internal controls

Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. Therefore, we will focus our control review on the high risk areas of the financial statements.

We are also required to assess whether the controls have been implemented as intended. We will do this through a combination of inquiry and observation procedures, and, where appropriate, systems walkthroughs. However, our work cannot be relied upon necessarily to identify defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

# Update on accounts audit risk assessment

As part of our planning and control evaluation work we have reviewed the audit risks identified in our Audit Plan 2010/11 and have set out opposite the outcome of work completed to date and further work planned.

Our updated review of the risks facing the Council has not identified any new risk areas.

We will report our full findings and conclusions in respect of each risk identified in our Annual Report to Those Charged with Governance (ISA 260) on completion of our final accounts audit.

Issue	Audit areas affected	Work completed	Further work planned
Accounting under IFRS	All areas of the financial statements	<ul style="list-style-type: none"> <li>A specific review of the Council's preparedness for IFRS has been completed. The results of this review have been reported to the Finance Team in a red/amber/green (RAG) format</li> <li>We have maintained ongoing liaison with the Finance Team regarding emerging IFRS issues and guidance and have been provided with support for any proposed changes to accounting treatment being considered under IFRS</li> </ul>	<ul style="list-style-type: none"> <li>We will continue to maintain ongoing liaison with the Finance Team regarding emerging issues and new guidance released up until the signing of the 2010/11 financial statements</li> <li>Our substantive audit procedures will focus on the high risk areas identified as a result of the transition to IFRS, in particular property, plant and equipment (PPE)</li> </ul>
Accounting for housing benefit debts	Current assets	<ul style="list-style-type: none"> <li>Queries have been made of the Finance Team and Housing Benefits Team to update our understanding of the measures put in place to address prior year audit findings in this area</li> </ul>	<ul style="list-style-type: none"> <li>Systems testing will be undertaken in June alongside detailed housing benefits testing required by the Audit Commission's 'HB COUNT' approach, following submission of the 2010/11 subsidy claim</li> </ul>

# Update on accounts audit risk assessment (continued)

The specific accounts assertion risks by cycle which we consider to present a 'reasonably possible' risk of material misstatement to the financial statements are detailed in appendix B to this memorandum

Issue	Audit areas affected	Work completed	Further work planned
Revaluation of fixed assets	Property, plant and equipment	<ul style="list-style-type: none"> <li>System walkthroughs and controls testing were scheduled to be undertaken in April to verify that controls relating to PPE activity and valuations are implemented and operating as expected</li> <li>these activities have been rescheduled for completion in June (see 'Results of interim work')</li> </ul>	<ul style="list-style-type: none"> <li>The use of valuation experts will be reviewed, to ensure that valuations have been completed in accordance with relevant IFRSs, in particular:                             <ul style="list-style-type: none"> <li>- the appropriateness of data and instructions provided to the expert</li> <li>- the methods and assumptions applied by the expert</li> </ul> </li> </ul>
Use of estimates and judgements	All areas of the financial statements	<ul style="list-style-type: none"> <li>Management representation has been obtained regarding the Council's use of estimates and judgements within the financial statements</li> <li>We have discussed the requirements for disclosures and supporting evidence for estimates and judgements within the financial statements including asset valuations, allowances, prepayments, accruals and provisions</li> </ul>	<ul style="list-style-type: none"> <li>In line with the requirements of the 'Clarity' ISAs, we will review the calculation for each significant estimate and judgement included in the financial statements.</li> <li>We will review any assumptions made in respect of these for reasonableness including the impact of any identified estimation uncertainties</li> </ul>

# Results of interim audit work

## Scope

As part of the interim audit work, and in advance of our final accounts audit fieldwork, we considered:

- the effectiveness of the Internal Audit function;
- internal audit's work on the Council's key financial systems;
- a review of closedown procedures in preparation for the final accounts under International Financial Reporting Standards (IFRS);
- walkthrough testing and tests of controls to confirm whether controls are implemented as per our understanding in areas where we have identified high accounting risk; and
- a review of Information Technology controls

## The internal audit function

We review internal audit's overall arrangements against the 2006 CIPFA Internal Audit Standards. Where the arrangements are deemed to be adequate, we can gain assurance from the overall work undertaken by internal audit and can conclude that the service itself is contributing positively to the internal control environment and overall governance arrangements within the Council.

Overall, we have concluded that the Internal Audit service continues to provide an independent and satisfactory service to the Council and that we can take assurance from their work in contributing to an effective internal control environment at the Council.

In preparation for our final accounts audit, we sought to review internal audit's work on the financial systems.

In assessing the effectiveness of internal audit work, we reviewed three internal audit files to ensure that:

- systems were adequately documented;
- key controls have been identified and evaluated;
- key controls have been tested; and
- weaknesses have been reported to management

We were pleased to note from these files that no issues were identified with internal audit's work and these were produced to a high standard.

## Closedown procedures

Our review considered the Council's timetable for closedown and the arrangements for preparing the draft IFRS accounts, including guidance provided on working papers required to be made available as part of the closedown process.

The Council has established a suitable timetable and expects to meet the accounts submission requirements in a timely manner. The Council also expects to be able to provide detailed working papers to support the accounts at the start of our final accounts audit fieldwork, which is scheduled to commence on 4th July 2011, as well as providing the draft Annual Governance Statement in advance of this date.

## Results of interim audit work (continued)

### Walkthrough testing and test of controls

Walkthrough tests and tests of controls were scheduled to be undertaken in April 2011 in relation to the specific accounts assertion risks by cycle which we consider to present a 'reasonably possible' risk of material misstatement to the financial statements. (These risks are detailed in Appendix B to this memorandum).

Unfortunately we have not yet been able to complete our work as planned in the area of property, plant and equipment due to minor delays relating to the availability of some asset valuations. This work has accordingly been rescheduled for completion in June 2011 and the results will be considered as part of our accounts audit planning process prior to the commencement of our final accounts audit fieldwork.

No significant issues were noted where walkthrough testing was able to be completed as planned and in-year internal controls were observed to operate satisfactorily in accordance with our documented understanding.

### Review of information technology controls

Our information systems specialist performed a high level review of the general IT control environment, as part of the overall review of the internal controls system. We have also performed a follow up of the issues that have been raised in the previous year. We concluded that, from the work undertaken to date, there are no material weaknesses which are

likely to adversely impact on the Council's financial statements.

We have, however, reiterated areas for improvement during the course of our work in these areas. We do not consider these to pose a significant risk to the accounts, and have reported them to management through our interim audit feedback meeting.

# Appendices

## A. Logistics

### Timetables and milestones

The following proposed timetable and deadlines have been set and agreed with management:

Event	Date
Pre year end fieldwork including internal controls review	Mar-Apr 2011
Completion of outstanding internal controls reviews and housing benefits testing	June 2011
Statutory accounts emailed to auditor	30 June 2011
Commence accounts audit fieldwork	4 July 2011
Manager visit to review work	July 2011
Partner visit to review work	July 2011
Clearance meeting to discuss our findings	27 July 2011
Report to Finance Audit and Risk Committee (ISA 260)	19 Sept 2011

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable. An agreed format and schedule of informal update arrangements will be maintained throughout the course of our audit fieldwork in support of this aim.

### Engagement team

In accordance with our Audit Plan 2010/11 issued February 2011, the main engagement team for the accounts audit will include:

Name	Role	Contact details
Phil Westerman	Engagement partner	T: 0207 728 2548 E: <a href="mailto:philip.r.westerman@uk.gt.com">philip.r.westerman@uk.gt.com</a>
Denis Thorpe	Audit manager	T: 07768 326514 E: <a href="mailto:denis.thorpe@uk.gt.com">denis.thorpe@uk.gt.com</a>
Natalie Sharp	Audit senior	T: 0207 728 2416 E: <a href="mailto:natalie.sharp@uk.gt.com">natalie.sharp@uk.gt.com</a>

### Information requirements

The information and working paper requirements that would assist us in an efficient and timely audit of the year-end financial statements have been communicated to the finance team within our Arrangements Letter, which was issued in March 2011.

## B. Accounts assertion risks by cycle

A reasonably possible risk is defined as being where:

- Numerous and often very precise controls should be established by management
- Substantive procedures would vary if controls were tested
- Inherent risk factors increase the likelihood of a material misstatement

### Property, plant and equipment

#### Valuation - Gross

##### Risks

Property, plant and equipment activity not valid

Revaluation measurements not correct

##### Intended control reliance

Tests of controls will be performed to verify that controls operate effectively

Walkthroughs will be performed to verify that controls are implemented

### Operating expenses

#### Completeness

##### Risks

Creditors understated or not recorded in correct period

##### Intended control reliance

Walkthroughs will be performed to verify that controls are implemented

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### Council Tax Revenue

#### Completeness

##### Risks

Tax revenue transactions not recorded

##### Intended control reliance

Walkthroughs will be performed to verify that controls are implemented

#### Existence/Occurrence

##### Risks

Recorded debtors not valid

##### Intended control reliance

Walkthroughs will be performed to verify that controls are implemented

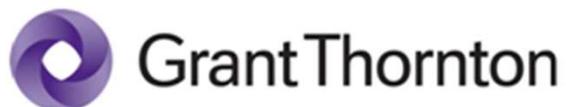
#### Valuation - Net

##### Risks

Allowance for doubtful accounts not adequate

##### Intended control reliance

Walkthroughs will be performed to verify that controls are implemented



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