

## **AUDIT COMMITTEE**

**20 DECEMBER 2012**

### **EXTERNAL AUDITOR PLANNING LETTER 2012/13**

Report from: Mick Hayward, Chief Finance Officer

Author: Mick Hayward, Chief Finance Officer

#### **Summary**

This report and attachment sets out the proposed fees and outline programme of work for PKF, the council's external auditor, for the 2012/2013 financial year.

#### **1. Budget and Policy Framework**

- 1.1 The Planning Letter for 2012/2013, produced by PKF, is attached as Appendix A to this report. This letter sets out the proposed fees and programme of work for the 2012/2013 financial year and is a matter for the Audit Committee.
- 1.2 The council's external auditor is required to report to the Audit Committee their proposed fees and outline programme of work. The Chairman is asked to accept this as an urgent item so that the Committee can consider the item at the earliest opportunity, rather than await the next scheduled meeting in March 2013.

#### **2. Proposed Audit Fees**

- 2.1 The Planning Letter 2012/2013, attached at Appendix A, reports a proposed fee for 2012/2013 of £212,410.
- 2.2 In addition to certification work this fee covers:
  - audit of the financial statements and the whole of government accounts assurance statement,
  - value for money conclusion.

It is based on the work required under the Audit Commission's *Code of Audit Practice* and PKF's assessment of risk and audit resource required to complete this work; taking into account the strength of the council's control environment, coverage of internal audit work and previous audit experience.

- 2.3 It is noted that the 2012/2013 fee is the scale fee recommended by the Audit Commission and represents a reduction of £185,000 when compared to the final fee for the period ended 31 March 2012. Members are advised that the

level of fee proposed is based upon assumptions by PKF concerning the preparation and publication of the annual financial statements and also that previously identified weaknesses in internal control have been addressed.

- 2.4 PKF will complete a detailed risk assessment in January 2013 and will write to the Audit Committee, if necessary, setting out any changes required to the proposed audit fee.

### **3. External Auditor Propose Work Programme**

- 3.1 An audit plan will be issued by PKF once they have completed their detailed risk assessment in early 2013. The Planning Letter however outlines PKF's proposed work programme and planned risk-based value for money work for 2012/2013 to date.

- 3.2 The following specific areas have been identified for review:

#### Financial Statements

- Controls relating to the preparation and authorisation of journals (including school journals).
- Controls of expenditure authorisation of non-purchase order invoices.
- Controls over requests for, and subsequent authorisation of, sundry debtor accounts.
- Balances and proposed accounting treatment in the preparation of the 2012/2013 financial statements.
- Long terms assets – testing on transactions and balances produced by the council's asset management system (Logotech).
- Municipal Mutual Insurance and the implications of a recent legal ruling for the council's financial statements.
- Audit of 2013/14 financial statements and the implications of HM Treasury guidance on the depreciation of infrastructure and CIPFA consultation on recognition of schools' assets.

#### Value for Money

- The Medium Term Financial Strategy – financial resilience and how the strategy is addressing funding and other pressures.
- An assessment of progress made by the Health and Wellbeing Board in addressing health issues and inequalities.
- Progress against Council Plan priorities and consideration of how the council secures economy, efficiency and effectiveness.
- The development and implementation of a local Council Tax Benefit support scheme by 1 April 2013.
- A review of progress made and review of the cost savings identified by the 'Better for Less' Programme.

### **4. Financial and Legal Implications**

- 4.1 The financial implications are set out in the external auditor's letter (attached). There are no legal implications arising from this report.

## **5. Risk Management**

- 5.1 PKF has identified a number of risk areas that may impact on their proposed approach to the audit of the financial statements for 2012/13. These are set out in section 3.2. The external auditor is also undertaking a detailed risk assessment that will be completed in January 2013 and will write, if necessary, to the Audit Committee setting out any changes required to the proposed audit fee.

## **6. Recommendation**

- 6.1 The Audit Committee note the content of the 2012/2013 Planning Letter.

Background papers: None

Lead Officer Contact:

Mick Hayward: Chief Finance Officer



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# Planning Letter 2012/13

REPORT TO AUDIT COMMITTEE

Medway Council

DECEMBER 2012



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# proposed audit fees

## INTRODUCTION

We are required to report to you our proposed fees and programme of work for the 2012/13 financial year. The fee is based on the work required under the Audit Commission's *Code of Audit Practice* and our assessment of risk and audit resource required to complete this work, taking into account the strength of your control environment, coverage of internal audit work and previous audit experience.

The audit fee covers:

- audit of the financial statements and the whole of government accounts assurance statement
- value for money conclusion.

## PROPOSED FEES

A summary of the proposed fee, and how it compares to the published Audit Commission scale fee for 2012/13 and the actual fees for 2011/12, is shown below.

Audit area	Proposed fee 2012/13 (£)	Scale fee 2012/13 (£)	Actual fee 2011/12 (£)
<b>Code audit work</b>			
- financial statements	141,345		294,000
- value for money conclusion	47,115		79,100
<b>Total Code audit work</b>	<b>£188,460</b>	<b>£188,460</b>	<b>£373,100</b>
<b>Certification fees</b>			
- Grants and returns	23,950	23,950	45,000
<b>Total proposed fees</b>	<b>£212,410</b>	<b>£212,410</b>	<b>£418,100</b>

The proposed fee for the 'Code' audit represents a reduction of £185,000 (49 per cent) when compared to the final fee for the period ended 31 March 2012. The proposed fee is the scale fee recommended by the Audit Commission. In previous years, the fee has been increased substantially because of errors and inconsistencies found by our audit of the financial statements. The proposed fee

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assumes the Council will have successfully implemented its improvement plan for preparing and publishing the annual financial statements. The fee also assumes weaknesses in internal controls identified through the work of internal and external audit in previous years have been satisfactorily addressed. When our detailed risk assessment is completed in January 2013, we will write to the Audit Committee setting out any changes required to the proposed audit fee.

#### AUDIT COMMISSION SCALE FEE CHANGES

In March 2012 the Audit Commission completed its procurement exercise to award new contracts and was able to secure significant reductions in the cost of audit services. Together with further savings achieved through efficiencies, the Audit Commission has been able to pass on reductions of up to 40 per cent in audit fees for the five years of the contracts.

The published scale fee for 2012/13 is based on 60 per cent of the original proposed fee for 2011/12 of £314,100. The final outturn fee for 2011/12 was £373,100 to reflect the additional work undertaken on certain aspects of the financial statements audit.

For 2012/13, the Audit Commission has replaced the previous schedule of maximum hourly rates with a composite indicative fee for certification work. The indicative fee is based on actual certification fees for 2010/11 adjusted because a number of schemes will no longer require auditor certification, and incorporating a 40 per cent reduction. Final outturn fees and findings from the audits of the 2011/12 certification returns and grants will be separately reported in our Certification report 2011/12 in January 2013.

#### VARIATION TO PUBLISHED SCALE FEE

The 2012/13 proposed fee of £188,460 for the code audit may be increased above the published scale fee to reflect the following:

- additional work required to obtain assurance over weaknesses in internal controls identified in previous years (noted in the 'proposed work' section below)
- the need to undertake detailed audit work on certain key financial systems where the Internal Audit section is not planning any review this year (as agreed with the Head of Internal Audit under our joint working arrangements)
- additional work necessary to review the Council's progress in addressing the significant matters arising from our 2011/12 audit where we identified errors, misstatements and inconsistencies and concluded the financial statements production process should continue to be improved.

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We will update the Audit Committee in respect of any variation to the composite indicative fee for the certification work once we have reported the 2011/12 findings in our Certification report early in 2013.

#### NON-AUDIT ASSURANCE WORK

We do not propose undertaking any non-audit services.

#### HOW TO REDUCE THE AUDIT FEE

The Council may be able to reduce the audit fee as follows:

- implementing effective management controls over the preparation and authorisation of journals, authorisation of expenditure and debtor invoice requisitions over the whole financial period
- improving the accounts preparation process and reducing the number of errors and inconsistencies contained in the financial statements. Particular attention is required for property, plant and equipment and government grant balances
- improving arrangements for preparing the Whole of Government Accounts return submitted to the Government Department.

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# proposed work

## INTRODUCTION

A separate audit plan will be issued early in 2013 once we have completed our detailed risk assessment. This will detail the significant financial statement and value for money risks identified and our planned audit procedures to respond to those risks and any associated changes in fee.

In this Planning Letter we outline the proposed work programme and planned risk-based value for money work.

## FINANCIAL STATEMENTS

Our audit strategy proposes that we obtain assurances over the financial statements using a combination of testing the effectiveness of the Council's internal controls, testing a sample of transactions and balances in the accounts, and analytical procedures.

We will seek to rely on the work of any management expert used to prepare items in the accounts, such as land and property valuations provided, pensions actuaries for valuation of the Council's share of the pension fund assets and liabilities, and insurance actuaries for assessing insurance provisions and reserves.

To date, we have noted the following risk areas that may impact on our proposed approach to the audit of the financial statements for 2012/13.

### **Review of journals and authorisation**

Controls over the preparation and authorisation of journals (including schools journals) should be consistently applied. We reported the deficiencies in these controls in 2011/12 and management agreed to improve procedures in this area with effect from April 2012.

We intend to review the enhanced controls as part of our financial systems audit in April 2013. If any issues are identified as a result of this work we will report the impact on the financial statements audit to the Audit Committee as soon as practicably possible.

### **Expenditure authorisation**

Authorisation controls over non-purchase order invoices should be improved. Deficiencies in these controls in the previous year resulted meant some officers were approving invoices to be paid which were above their approved limits.

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Since we reported these deficiencies in controls, management has assured us that from September 2012, the Council has improved its processes and controls in this area.

We intend to review the improved controls as part of our financial systems audit in April 2013 and also intend undertaking additional testing over non-purchase order invoices where deficiencies in controls were evident for the first six months of the year (and before enhanced procedures were implemented).

### **Sundry Debtor Requisitions**

In 2011/12 we reported the deficiencies in controls over requests for, and subsequent authorisation of, sundry debtor accounts and that controls should be implemented in accordance with financial operating procedures.

Since we reported these deficiencies in controls management has assured us that with effect from September 2012, the Council has established improved processes and controls in this area.

We intend to review the improved controls as part of our financial systems audit in April 2013 and also intend undertaking additional testing over debtor invoices where there were deficiencies in the controls for the first six months of the year (and before enhanced procedures were implemented).

### **Preparation of the financial statements**

The Council should continue to work towards and update its improvement plan to ensure fully effective arrangements for producing the annual financial statements are embedded.

The closedown timetable should include sufficient capacity to complete a qualitative review of the draft financial statements before submission to audit.

We will continue to work with officers and undertake early review of balances and proposed accounting treatment in the lead up to producing the 2012/13 financial statements.

### **Long term assets**

In 2011/12, we reported inaccuracies in amounts and inconsistencies in the application of accounting policies for property, plant and equipment and heritage asset balances. The Council accepted our recommendations that:

- management more fully documents the annual review of useful lives, depreciation methods and residual values of all classes of assets
- management reviews all fully depreciated assets in order to determine whether the assets remain in use and whether such assets should be revalued in accordance with the Council's policies

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- management reviews assets with a 'negative' value to determine the correct carrying values and useful economic life
  - a full valuation of Heritage Assets as at 1 April 2012 is obtained to inform the closure of the 2012/13 accounts.

The Council operated an enhanced asset management system (Logotech) in 2011/12 and significantly improved the process for producing fixed asset balances compared to 2010/11. We also highlighted the system should be embedded to reduce further the number of errors and inconsistencies in the financial statements.

As fixed asset balances account for a major proportion of the balance sheet, and because the transactions can be complex in nature, we will carry out a detailed review and additional testing on transactions and balances produced by the Logotech system.

#### **Municipal Mutual Insurance (MMI)**

Under the scheme of arrangement with MMI, local authorities may be required to reimburse amounts to MMI in the event that it does not have sufficient resources to meet its insured obligations. MMI was recently subject to a legal ruling regarding a claim for mesothelioma that confirmed that it remains responsible for liabilities that existed at the time of exposure, rather than from the time the symptoms start to develop. There is an expectation that MMI will now be subject to many similar claims and has indicated that the scheme of arrangement may need to be triggered.

The Council reported this event and potential exposure as a contingent liability in the 2011/12 financial statements. Further information is likely to be made available from MMI regarding the financial impact of this ruling and the Council, along with many other local authorities, will need to consider if the judgement creates greater certainty about the likelihood of their liability crystallising and whether it should therefore report amounts as a provision within the financial statements.

#### **Audit of 2013/14 financial statements**

Although not directly impacting on the 2012/13 financial statements, there are a number of developments that are likely to impact on the Council in 2013/14 where we would wish to maintain on-going dialogue:

- valuation of infrastructure on a depreciated replacement cost rather than historical cost to align with HM Treasury guidance
- CIFPA consultation on recognition of schools' assets.

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## VALUE FOR MONEY

We are required to assess the Council's arrangements to:

- secure financial resilience
- challenge how it secures economy, efficiency and effectiveness.

We have noted the following local risks that impact on our value for money audit:

### **Medium term financial strategy**

The Government continues to reduce its funding to local government over the Spending Review period. Combined with additional pressures arising from demographic and other changes, further risks are emerging for all Councils to balance their financial positions over the medium and longer term planning horizons.

Changes to the arrangements for funding council tax support and the business rate retention scheme, along with the transfer of responsibility for public health services to local authorities such as Medway, provide further uncertainties to medium term financial planning.

We intend to review the Council's medium term financial strategy to assess how well it is addressing such pressures and to review financial resilience.

### **Health and Wellbeing Board**

The Health and Wellbeing Board will assume its full statutory powers from April 2013, bringing together aspects of local government services and the NHS and with the input of local people. The Council will need to complete the transfer of staff from demising NHS organisations while managing the risks identified by the Shadow Health and Well Being Board to the achievement of outcomes for the Medway area.

We will continue to assess the progress made by the Medway Health and Well Being Board to address health issues and inequalities across the area with its partners.

### **Progress against priorities**

Priority areas have been identified in "The Council Plan 2012/13" and key success measures to achieve such priorities are monitored on a quarterly basis by the Cabinet and scrutiny committees.

We will monitor the progress towards the Council's priorities and use outturn performance and outcomes to challenge how the council secures economy, efficiency and effectiveness.

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### **Localisation of Council Tax Benefit**

In March 2012 the parliamentary bill, Welfare Reform Act 2012, was approved and it abolishes the current Council Tax Benefit arrangement and introduces a local council tax support scheme which will need to be administered by local authorities from 1 April 2013.

The Local Government Finance Act 2012 sets out a framework for this new scheme and local authorities must develop and approve a scheme by 31 January 2013 and which qualifies for the additional funding made available by DCLG.

The Council has developed a preferred scheme with two additional options and has completed its consultation with the public in accordance with the national timetable. The Cabinet has agreed a local scheme should be drawn up to be approved by the Full Council by 31 January 2013.

We will continue to monitor the Council's development and implementation of the new scheme and consider the risks to achieving the Council's targets for administering benefit as senior benefit officers become involved in developing and implementing the new scheme.

### **'Better for Less' Programme**

The Council continues to implement the 'Better for Less' programme designed to achieve efficiencies through restructuring the delivery of its support services and to provide greater support to front line departments to deliver improvements in commissioning. Underpinning this is a new 'category management' approach designed to ensure corporate procurements are undertaken efficiently and consistently.

We intend reviewing the progress made and to review the cost savings identified by management.

### **CHANGES TO PROPOSED WORK AND FEES**

If we need to propose any amendments to the audit fee during the course of the audit, where our assessment of risk and complexity are significantly different from those reflected in the proposed fee, we will first discuss this with the Chief Finance Officer and inform the Audit Committee of a proposed variation of fee. If necessary, we will also prepare a report outlining the reasons why the fee needs to change for discussion with the Committee.

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# planned outputs

## REPORTS AND OPINIONS

We plan to issue the following reports and opinions over the course of the audit:

- audit plan (March 2013)
- if appropriate, report on significant deficiencies in internal controls (June/July 2013)
- annual governance report (September 2013)
- auditor's report with opinion on the financial statements and value for money conclusion (September 2013)
- auditor's report and assurance statement on the Whole of Government Accounts L-Pack (September 2013)
- annual audit letter (October 2013)
- grants claims and returns certification report (January 2014).

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# audit team

## KEY MEMBERS OF THE AUDIT TEAM

### **Engagement Lead – Robert Grant**

email: [robert.grant@uk.pkf.com](mailto:robert.grant@uk.pkf.com)

Tel: 020 7065 0170

Robert will be responsible for the overall delivery of the audit including the quality of outputs and liaison with senior management.

### **Engagement Manager – Kerry Barnes**

email: [kerry.barnes@uk.pkf.com](mailto:kerry.barnes@uk.pkf.com)

Tel: 020 7065 0217

Kerry will manage and co-ordinate each aspect of the audit and will be the key contact with the Finance team.

### **Team Leader – Jody Etherington**

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Jody will lead the delivery of the accounts audit.

## CLIENT SATISFACTION

We are committed to providing you with a high quality service. If you are in any way dissatisfied, or would like to discuss how we can improve our service, please contact Robert Grant in the first instance. Alternatively, you may wish to contact our Managing Partner, Martin Goodchild. Any complaint will be investigated carefully and promptly. If you are not satisfied you may take up the matter with the Institute of Chartered Accountants in England and Wales (“ICAEW”).