AUDIT COMMITTEE

29 MARCH 2011

ANNUAL AUDIT PLAN 2010/2011

Report from: Mick Hayward, Chief Finance Officer

Author: Mick Hayward, Chief Finance Officer

Summary

This report and attachment sets out the annual audit plan. The Council's external auditors (PKF) have produced the plan and it is reported to this committee to comply with governance requirements.

1. Budget and Policy Framework

1.1 International Standards on Auditing require the audit plan to be communicated to 'those charged with governance.' The terms of reference of this committee include: discussions with the external auditor on new accounting standards, changes to the reporting framework and the basis of the annual audit, including the content of performance work.

2. Background

2.1 In accordance with the International Standards on Auditing (UK and Ireland) 260 it is necessary to communicate the annual audit plan for 2010/2011.

2.2 As the external auditor, independently appointed by the Audit Commission, PKF has a responsibility to audit and provide an opinion on the Statement of Accounts and to provide a conclusion on the use of resources.

2.3 The annual audit plan for 2010/2011, produced by PKF, is attached as Appendix 1 to this report.

3. Scope of the Plan

3.1 The overall scope of the work to be carried out is determined by the Audit Commission's Code of Audit Practice and PKF have drawn up the detailed plan in accordance with their risk based approach to audit planning and planning meetings held. PKF will target work where it will have the greatest effect based upon assessments of risk and performance.

3.2 The scope of the audit work is set out in the attached plan and indicated areas where the approach to audit will change as a consequence of revised International

Standards on Auditing which apply to local authority financial statements for years ending on or after 15 December 2010.

4. Financial and Legal Implications

4.1 Audit fees are calculated in accordance with national scales established by the Audit Commission. PKF have confirmed their provisional fee, agreed by this committee on 30 June 2010, of £349,000 compared to a fee for 2009/2010 of £329,000. This sum is marginally above Audit Commission’s guideline fee. However, as previously reported, the Audit Commission will reimburse the Council £21,486 in recognition of increased audit costs incurred as a consequence of the introduction of IFRS. In addition, following the introduction of a more focussed approached to auditor’s VFM work, the Audit Commission will give the Council a rebate of approximately £12,800. The audit fee is within existing budget provision.

4.2 The planned fee for certification of grant claims and returns is £80,000 which, although higher than the estimated fee for 2009/2010 of £77,000 is a considerable reduction from the actual fee of £86,000 for that year. A separate report on this agenda identifies the main for the increase in fees for 2009/2010.

4.3 The International Standards on Auditing require the plan to be communicated to discharge governance requirements.

5. Risk Analysis

5.1 PKF have assessed the key audit risks which are contained within Appendix A of the audit plan. However, there will always be a risk that the auditor may find material errors or misstatements in the accounts and the results of the audit of the statements will not be known before they are presented for adoption by the Council as part of the Audit Committee function. Due regard will be taken of the changing regulations and accounting requirements in producing the 2009/2010 statements and the position put before the Audit Committee is the officers’ interpretation of these requirements.

6. Recommendation

6.1 That the Audit Committee accepts the proposed annual audit plan for 2010/2011.

Background papers

The annual audit plan 2010/2011 (attached as Appendix 1)

Report author: Mick Hayward, Chief Finance Officer.

Appendix 1

PKF

Accountants &
business advisers

Medway Council

Annual Audit Plan 2010/11

March 2011

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Appendices

Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission contains an explanation of the respective responsibilities of auditors and of the audited body. Reports and letters prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.

Code of Audit Practice

Statement of Responsibilities

1 Executive summary

1.1 The purpose of this Annual Audit Plan is to inform you of the work we propose to undertake in respect of the audit of the accounts and to review Medway Council's (the Council) arrangements for securing value for money for the 2010/11 financial year. The Plan updates the fee letter discussed with the Audit Committee in June 2010 now that we have concluded our 2009/10 audit. The Plan also considers emerging issues such as the outcome of the new Government's Comprehensive Spending Review and the 2011/12 grant settlement for Medway.

Significant audit risk areas

Accounts

1.2 These are set out in detail in section 3 and Appendix A, and include:

- the risk of management override of controls (this is a non-rebuttable risk under international standards on auditing)
- implementation of International Financial Reporting Standards (IFRS)
- weaknesses in the maintenance of the fixed asset register which meant in 2009/10, the register did not support production of balances which fully followed the Council's policies.

Value for money

1.3 The Government's grant settlement announced for Medway in December 2010 indicates a reduction in its 'Formula Grant' of 11.9 per cent in 2011/12 and a cumulative reduction of 19.9 per cent (compared to the 2010/11 amount) by 2012/13. The settlement compares to the Council's expectations based on its financial modelling that Formula Grant would reduce by 25 per cent over the four year period to 2014/15. The 2011/12 budget identifies savings and other reductions in resources required of £23.5 million.

1.4 The Council has established arrangements and a track record for securing value for money, which we have assessed positively in previous years. However, the Council is dealing with a challenging financial outlook, is reviewing its priorities based on consultation with stakeholders and is taking action to improve performance in certain services. We will consider the Council's response to the risks arising from this challenging agenda in completing our detailed risk assessment and value for money conclusion work.

1.5 Other significant issues affecting our value for money conclusion include:

- evidencing value for money is secured from strategic procurement decisions
- securing the further improvement required in services where performance is behind the Council's targets
- balancing the 2010/11 budget and the medium term financial plan following the reduction in Medway's resources announced in the new coalition Government's Emergency Budget and Comprehensive Spending Review
- maintaining the level of general reserves and balances at a level sufficient to address the significant risks and uncertainties the Council is facing.

1.6 Other emerging issues include:

- the increased responsibilities for the planning, commissioning and provision of NHS and adults and children's social care services following the new Government's White Paper entitled 'Equity and Excellence: Liberating the NHS' and the abolition of primary care trusts from April 2013

- the further establishment of 'Academy' schools in Medway and the impact on the Council's local education authority responsibilities and finances.

Fees

1.7 The audit fee for the year is £349,000. It has not been necessary to make any amendments to the audit fee since we issued our Audit Fee Letter to you. However, the Audit Commission decided a rebate for 2010/11 should be paid as a result of the Government's May 2010 announcement that it did not wish work on Comprehensive Area Assessment (CAA) to continue, and in recognition of the introduction of a more focused approach to auditors' value for money work. The result of the Commission's decision is that Medway will receive a rebate of about £12,800 (3.5 per cent of the Audit Commission's scale fee) for the 2010/11 year though the final amount has not yet been notified.

1.8 For the 2010/11 financial statements audit, the Audit Commission has already provided a six per cent rebate of the scale audit fee to mitigate the increase arising from the transition to IFRS. The Audit Commission wrote to the Council in February 2010 providing a rebate of £21,486 accordingly.

1.9 The total rebate to be provided by the Audit Commission for the 2010/11 year is therefore about £34,200.

1.10 The assumptions we have made in setting the 2010/11 audit fee are set out in section 4.

1.11 Our audit of grant fees for claims and returns for the year ended 31 March 2010 is complete and the outturn fee is £86,000 which is above the planned amount of £77,000 and compares to the 2008/09 fee of £78,110. The additional fee arose mainly because of additional work necessary on the Housing and Council Tax Benefit Subsidies grant claim and the Teacher's Pensions annual return.

1.12 Based on our experience and taking account of grade rate changes outlined in the Audit Commission's Work Programme and Fees document for 2010/11, we anticipate fees for claims and returns for the year ended 31 March 2011 to be approximately £80,000.

Key outputs

1.13 The key reports, opinions and conclusions from the audit will be:

Output	Expected timing
Accounts	
Review of internal controls report to those charged with governance	June 2011
Audit opinion and annual governance report on financial statements Opinion on the Whole of Government Accounts return	September 2011
Value for money	
Risk Assessment	December 2010 – September 2011
Value for money conclusion	September 2011
Annual reporting	
Annual audit letter	November 2011
Grants	
Grants claim report to those charged with governance (for the 2009/10 financial year)	February 2011

2 Introduction

2.1 This Annual Audit Plan sets out the audit work we propose to undertake for the 2010/11 financial year. It has been drawn up from our risk based approach to audit planning and planning meetings held. The information and fees in this Plan will be kept under review and any significant changes will be reported to the Audit Committee.

2.2 The context in which we deliver our audit is set out in Appendix B.

Assessing risks

2.3 We are committed to targeting work to where it will have the greatest effect, based upon assessments of risk and performance. This means planning our audit work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees. It also means ensuring that our work is co-ordinated with the work of other regulators, and that our work helps you to improve.

2.4 Our risk assessment process focuses on the identification of significant financial and operational risks. For each of the significant risks identified, we consider the arrangements put in place to mitigate the risk and plan our work accordingly.

Impact of the introduction of Clarity International Standards on Auditing (clarified ISAs)

2.5 For the audit of financial statements for years ending on or after 15 December 2010, we are required to apply the clarified (or revised and redrafted) International Standards on Auditing (UK & Ireland). These have increased the number of requirements that have to be met when carrying out an audit and you are likely to notice a change in our approach to the audit of certain areas. Consequently we may require additional information from you or we may request information at a different stage of the audit process than has been the case in previous years.

2.6 Examples where our approach to the audit may change as a result of the additional requirements of the clarified ISAs include (but is not limited to) the following areas.

Materiality

2.7 We are required to set, not only a materiality level against which to evaluate the effect of identified misstatements on the audit but also a second level of materiality (known as 'performance materiality') which is to be used when planning and performing the audit. This has to be set at a level lower than the materiality for the financial statements as a whole to reduce to an appropriately low level the probability the aggregate of uncorrected and undetected misstatements exceeds materiality (for the financial statements as a whole). The potential impact is that areas previously unaudited on the grounds of materiality may now fall within the scope of our audit work; or more work may have to be completed in certain areas to reflect the lower level of materiality.

Related parties

2.8 Whilst under the existing ISAs we were required to obtain an understanding of the related parties of the entity, including the controls that those charged with governance have in place over the identification and accounting for related parties, the clarified ISAs place a greater emphasis on a risk based approach to the consideration of this area. We use our understanding to assess the risk of material misstatement of the financial statements in respect of related parties and design further audit procedures accordingly. Our audit work on related parties will also include consideration of transactions that have occurred, if any, outside the normal course of business and in identifying any omitted related party relationships and transactions.

Accounting estimates

2.9 We will consider all areas of the financial statements subject to accounting estimates and we are required to understand how those estimates have been determined and consider the effects of uncertainty in assumptions used. We will identify and assess the risks of material misstatement arising from the use of accounting estimates and will focus our work on areas where the risks of material misstatement are greatest. Our audit work on accounting estimates will also focus on identification of any possible instances of management bias.

2.10 The Auditing Practices Board previously estimated that these additional requirements would increase the cost of an audit of an entity such as Medway Council.

Control environment

2.11 Under the existing ISAs we were required to report to Those Charged with Governance any significant weaknesses in the control environment identified during the audit. The clarified ISAs place an increased emphasis on the need to communicate in writing significant deficiencies in internal control identified during the audit to Those Charged with Governance on a timely basis. In addition, we must report other deficiencies in internal control identified during the audit that are of sufficient importance to merit management's attention. As a consequence, it may be necessary for us to produce additional reports to management and Those Charged with Governance, about weaknesses identified in the control environment at the Council.

3 Risk assessment

Significant financial statement audit risks

3.1 Summarised below are the significant accounts risks that are likely to impact on our audit of which we are currently aware. More detail on these risks can be found in Appendix A.

Management override

3.2 International Standards on Auditing (UK and Ireland) presumes that a risk of management override of controls is present in all entities and requires us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual. We are also required to consider the need to perform additional audit procedures.

International Financial Reporting Standards

3.3 Full implementation of International Financial Reporting Standards (IFRS) in local government from 2010/11 poses a risk that the Council may not appropriately apply IFRSs in the production of its financial statements, including restatement of prior year comparative figures. This could impact on the accuracy of a number of balances and income and expenditure totals and the completeness of disclosures within the financial statements.

Fixed Asset Register

3.4 In 2009/10, the fixed asset register did not fully support the disclosure of balances in accordance with the Council's policies and material amendments were made to the accounts. The Council has been reviewing the fixed asset register in 2010/11 as part of the transition to IFRS and we will consider the outcome of that work to decide whether additional audit procedures are necessary to support our audit opinion.

3.5 We have set a triviality level of £180,000 for the 2010/11 accounts audit and will not report to you any matters arising below this level.

Emerging issues

3.6 The Government's grant settlement announced for Medway in December 2010 indicates a reduction in its 'Formula Grant' of 11.9 per cent in 2011/12 and a cumulative reduction of 19.9 per cent (compared to the 2010/11 amount) by 2012/13. The settlement compares to the Council's expectations based on its financial modelling that Formula Grant would reduce by 25 per cent over the four year period to 2014/15. The 2011/12 budget identifies savings and other reductions in resources required of £23.5 million.

3.7 The Council is continuing to review its priorities and assessing its financial resilience accordingly. The Council is continuing to keep the overall financial position in 2010/11 and the medium term financial plan under close review. We will consider the Council's response to the risks arising from this challenging agenda in completing our detailed risk assessment and value for money conclusion work.

Updated value for money conclusion risk assessment

3.8 We have updated our value for money risk assessment for 2010/11 to take into account:

- matters arising from the completion of the 2009/10 audit and reported in our annual audit letter
- additional audit knowledge gained since our initial risk assessment which was included in our 2010/11 Audit Fee Letter, presented to the Audit Committee in April 2010

- the introduction of the Audit Commission's revised arrangements for the determination of the value for money conclusion (see Appendix B).

3.9 The table below highlights further issues identified from our updated assessment.

Issue	Planned work
The Council is reviewing its strategic procurement arrangements to ensure value for money can be more fully evidenced from its procurement decisions.	We will review and comment on the Council's progress in establishing enhanced strategic procurement arrangements through our value for money risk assessment.
In order to meet the performance targets set for the year, the Council has taken action to: • improve the speed of completion of core assessments for children in social care and to reduce the number of children requiring Child Protection Plans for a second or subsequent time • improve the educational attainment of looked after children and other children with special needs • review those services provided to Carers and to increase the number of Adults with learning disabilities in employment. • improve performance towards Housing repairs and maintenance targets and to reduce the average time taken to re-let council dwellings • improve the speed of determining entitlement to benefit; homelessness applications and reducing the number of households in temporary accommodation.	Our value for money risk assessment will consider the Council's progress toward its priorities in 2010/11.

Emerging issues affecting the value for money conclusion

3.10 There are some issues that we intend to maintain an ongoing review of during the course of the year. Some of these are significant issues affecting the Council's resource base and the structure of public services in the Medway area, including:

- reductions in Medway's resources in 2010/11 and further significant reductions in the grant settlement from 2011/12 as a result of the new coalition Government's Comprehensive Spending Review and consequent impact on the Council's medium term financial plans; corporate priorities and the level of general reserves and balances
- the increased responsibilities for the planning, commissioning and provision of NHS and adults and children's social care services following the new Government's White Paper entitled 'Equity and Excellence: Liberating the NHS' and the abolition of primary care trusts from April 2013
- the further establishment of 'Academy' schools in the Medway area.

3.11 As circumstances arise we will respond to such emerging issues as shown below.

Issue	Response
Financial Resilience	
The Council is dealing with a difficult financial outlook and is currently reviewing its priorities and assessing its financial resilience.	Our VFM conclusion requires us to review the Council's arrangements for securing financial resilience. We will consider the Council's progress towards its 2010/11 budget, its arrangements for preparing the 2011/12 budget and the further development of the medium term financial plan. We will review the Council's approach to identifying and responding to financial risks and opportunities. We will also review progress made towards efficiency plans and the financial stability of the Council over the medium term. We will also consider the extent to which financial plans support achievement of Council priorities where these have been updated in the year.
The total amount of general balances and reserves available (£17.1 million as at 31 March 2010) will require careful management given the significant financial risks and uncertainties the Council is facing.	We will review achievement of the Council's strategy for maintaining its general balances and reserves at a prudent level. We will also review the scope and extent of earmarked reserves maintained as the Council further develops its priorities.
Value for money	
The coalition Government proposes significant changes in the way public services are managed and delivered. To date, the council is dealing with: • increased responsibilities for the planning, commissioning and provision of NHS and adults and children's social care services following the new Government's White Paper entitled 'Equity and Excellence: Liberating the NHS' and the abolition of primary care trusts from April 2013 • the further establishment of 'Academy' schools in the Medway area.	Our VFM conclusion requires us to assess the Council's arrangements for securing economy, efficiency and effectiveness. We will review the Council's approach to dealing with the significant changes proposed by the new Government for the public sector.

4 Fees and billing arrangements

Fees

4.1 The audit fee for the year is £349,000. It has not been necessary to make any amendments to the audit fee since we issued our Audit Fee Letter to you. However, the Audit Commission decided a rebate for 2010/11 should be paid as a result of the Government's May 2010 announcement that it did not wish work on Comprehensive Area Assessment (CAA) to continue, and in recognition of the introduction of a more focused approach to auditors' value for money work. The result of the Commission's decision is that Medway will receive a rebate of about £12,800 (3.5 per cent of the Audit Commission's scale fee) for the 2010/11 year though the final amount has not yet been notified.

4.2 For the 2010/11 financial statements audit, the Audit Commission has already provided a six per cent rebate of the scale audit fee to mitigate the increase arising from the transition to IFRS. The Audit Commission wrote to the Council in February 2010 providing a rebate of £21,486 accordingly.

4.3 The total rebate to be provided by the Audit Commission for the 2010/11 year is therefore about £34,200. In addition, the Audit Commission has mandated, on an annual basis, an overall assessment of every Local Authority's grants control environment and also a report to be issued to Those Charged With Governance covering the grants work undertaken. The additional work, which was not included in the Fees and Work Programme document, is estimated at £2,000 which is a significant reduction on the 2009/10 fee of £6,000 for the report. If we need to make further significant amendments to the audit fee during the course of the audit, we will first discuss this with the Chief Finance Officer and then prepare a report outlining the reasons why the fee needs to change for discussion with the Audit Committee.

4.4 The Audit Commission has published its proposals for the fees to be paid by local authorities in 2011/12. These proposals are being consulted on and indicate Medway's fee will amount to £314,100, as shown below.

Audit area	Actual fee 2009/10 £	Planned fee 2010/11 £	Estimated Fee 2011/12 £
Financial statements, including WGA	216,000	239,000	TBA
2009/10 Use of Resources work 2010/11 Value for money conclusion	113,000	110,000	TBA
Total Code audit fee	**£329,000**	**£349,000**	**£314,100**
Audit Commission Rebate (Approx.)	0	£(34,200)	0
Certification of claims and returns (1)	£86,000	£80,000	TBA
Grant claims report to those charged with governance	£2,000	£2,000	TBA
Non-Audit Services			
Advice and Assistance work (2)	0	£16,905	0

(1) The planned fee for the 2009/10 year was £77,000. The actual fee for the 2008/09 year was £78,110
(2) Advice and Assistance work commissioned by the Monitoring Officer, completed in September 2010

4.5 As well as the audit fee of £349,000 identified above, the following fees are separately billable:

Work	Estimate £	Billing arrangement
Questions and objections	TBA	Should any arise, time spent dealing with questions and objections will be billed separately. Where possible we will provide an estimate of the likely time required to respond to the matters before starting the work.
Grants certification	£80,000	Fees billed are based on the Audit Commission's grade related rates as set out in the *Work Programme and Fee Scales* on the basis of hours incurred. Our audit of grant fees for claims and returns for the year ended 31 March 2010 is complete and the outturn fee is £86,000 which is above the planned amount of £77,000 and compares to the 2008/09 fee of £78,110. The additional fee arose mainly because of additional work necessary on the benefit subsidies grant claim and the Teacher's Pensions return. A detailed report about the audit of grant claims will be made to Those Charged with Governance. Based upon our experience of this most recent set of reviews, we anticipate fees for claims and returns for the year ended 31 March 2011 will be approximately £80,000, taking account of grade rate changes outlined in the Audit Commission's Work Programme and Fees document for 2010/11.

4.6 The fees detailed above are based on the following assumptions:

- Internal Audit will have completed its systems testing in accordance with the plans and agreed timetable, and to an adequate standard
- Internal Audit will have completed its testing of housing and council tax benefit claims (see table above)
- We will, after re-performing a sample of Internal Audit's work, be able to place full reliance on the work of Internal Audit
- you will keep us informed of any significant changes to your main financial systems or procedures
- you will provide the information requested in our records required listing in accordance with the timetable agreed and that there will be no significant departures from the timetable. The firm reserves the right to increase its fees should this not be the case or should we encounter unexpected problems, or issues arise, causing significant additional work.
- time spent dealing with issues arising from our audit work is usually that of senior people and hence the cost will necessarily often be disproportionate to the original fee.
- you will ensure audit reports are responded to promptly and the implementation of recommendations by the due date is actively monitored
- there are no major changes to the content of government department grant instructions.

4.7 The fee assumes efficient co-operation as set out above and is set at the minimum level to carry out the audit. This assumption is based upon arrangements for 2010/11 and our consideration of your annual governance statement in your 2009/10 accounts.

Billing arrangements

4.8 Your audit fee is being billed in four equal instalments of £87,250 as shown below:

Month	£
June 2010	87,250
September 2010	87,250
December 2010	87,250
March 2011	87,250
Total	**£349,000**

5 Audit arrangements

Staffing

5.1 The following staff will be involved in the audit throughout the course of the year:

	Role and responsibility
Engagement Partner Robert Grant Email: robert.grant@uk.pkf.com Tel: 020 7065 0170	Responsible for delivering the audit in line with the Audit Commission Code of Audit Practice, including agreeing the Audit Plan, Annual Governance Report and Annual Audit Letter. Also responsible for signing opinions and conclusions, and for liaison with senior management and the Audit Committee.
Senior Manager Geraldine Daly Email: geraldine.daly@uk.pkf.com Tel: 020 7065 0000	Responsible for overall control of the audit, ensuring timetables are met and reviewing the audit output. Also responsible for managing our accounts and value for money work and for completion of the Audit Plan, Annual Governance Report and Annual Audit Letter.
Supervisor Kerry Barnes Email: kerry.barnes@uk.pkf.com Tel: 020 7065 0000	Responsible for managing our audit fieldwork on site for accounts and value for money.
ICT Auditor Simon Ghosh Email: simon.ghosh@uk.pkf.com Tel: 020 7065 0000	Responsible for assessing the Council's ICT arrangements.
VAT advisor Richard Wild Email: richard.wild@uk.pkf.com Tel: 01473 720744	Responsible for assessing the arrangements in place to manage the Council's responsibilities in respect of VAT.

Timetable

5.2 The following outline timetable shows the expected dates planned for key fieldwork elements of the audit to commence:

Audit Timetable	Timing
Accounts – core financial systems	April - May 2011
Accounts – financial statements	July - August 2011
Value for money – specific risks	September 2010 - September 2011
Value for money conclusion	September 2011
Grants reviews (including HBCOUNT benefits work)	June to November 2011

5.3 We will agree specific dates for our visits with officers in advance of each part of our programme, and we will work closely with officers during the year to ensure that all key deadlines are met. We will also meet regularly with senior officers to discuss progress on the audit and obtain an update on relevant issues. The expected timing of key outputs from the audit is set out in paragraph 1.12.

Communication

5.4 Auditing Standards require auditors to communicate relevant matters relating to the audit to “those charged with governance”. Relevant matters include issues on auditor independence, audit planning information and findings from the audit.

5.5 We have included in Appendix C to this Plan a statement to the Audit Committee setting out the Audit Commission’s objectivity and independence guidelines and giving our confirmation that we have complied with those guidelines.

5.6 Following our audit of the financial statements we will report to the Audit Committee on the findings from our audit.

Quality of service

5.7 We aim to provide a high quality of service to you at all times. If, for any reason or at any time, you would like to discuss how we might improve the service, or if you are in any way dissatisfied, 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.

5.8 If you are not satisfied you may take up the matter with the Institute of Chartered Accountants in England and Wales (“ICAEW”).

5.9 In addition, the Audit Commission’s complaints handling procedure is detailed in their leaflet “How to complain: What to do if you want to complain about the Audit Commission or its appointed auditors”, which is available on its website http://www.audit – commission.gov.uk/complaints/

Appendix A

Accounts Risk assessment matrix

	Audit risk identified from planning	Financial Statement Area & *Assertion*	Audit response
Accounts			
1	*International Financial Reporting Standards are being adopted in local government from 2010/11 and requires restatement of prior year comparative figures. There is a risk around transitional arrangements and preparation of the financial statements in compliance with IFRS. Failure to appropriately apply IFRS may impact on the accuracy of a certain balances, income and expenditure totals and disclosures within the financial statements.* *In 2009/10, our assessment rated the Council's preparedness as 'Amber', with only minor issues requiring attention in the lead up to producing IFRS compliant accounts as at 31 March 2011.*	*All Areas of Financial Statements* *Completeness* *Existence/Occurrence* *Accuracy* *Cut-Off* *Valuation* *Rights and Obligations*	*We will continue to work with the Finance section to monitor the Council's progress against implementation of its IFRS plan and management's transitional arrangements. In 2010/11, we will place particular audit emphasis on the following:* • *review of service arrangements against IFRIC 12 (service concessions)* • *review of arrangements against IFRIC 4 (lease arrangements)* • *consideration of leasing arrangements against IAS 17 (Leases)* • *review of valuation policies and component accounting for assets under IAS 16 (Property, plant and equipment)* • *calculation of employee benefits under IAS 19 (Employee benefits)* • *review of government grants in light of CiPFA's decision to apply IPSAS 23* • *review of group accounting requirements under IFRS which focuses on ability to control as opposed to actual control* • operating segment disclosures under IFRS 8 (Operating segments) • *additional, detailed audit procedures are also required in the restatement exercise of comparative balances for year ended 31 March 2009 and 31 March 2010.*

Italics = reported in fee letter presented to the Audit Committee on 28 June 2010
Non-italics = new risk

	Audit risk identified from planning	Financial Statement Area & *Assertion*	Audit response
Accounts			
2	*International Standards on Auditing [IFRS] (UK and Ireland) presumes that a risk of management override of controls is present in all entities and requires us to respond to this risk. We are also required to consider the need to perform other additional procedures.*	*All Areas of Financial Statements* *Completeness* *Existence/Occurrence* *Accuracy* *Cut-Off* *Valuation* *Rights and Obligations*	*We will test the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual. Should further audit procedures be required, we will notify management and the Audit Committee.*
3	In 2009/10, the fixed asset register does not fully support the disclosure of balances in accordance with the Council's policies. The Council has been reviewing the fixed asset register in 2010/11 in preparing for IFRS and we will consider the outcome of that work to decide whether additional audit procedures are necessary to support our audit opinion.	Balance Sheet; Comprehensive Statement of Income and Expenditure; relevant notes *Completeness* *Existence/Occurrence* *Accuracy* *Cut-Off* *Valuation* *Rights and Obligations*	We will discuss with officers the work completed by the Council to ensure the Fixed Asset Register supports production of IFRS compliant accounts.

Italics = reported in fee letter presented to the Audit Committee on 28 June 2010
Non-italics = new risk

Value for Money Risk Assessment and other emerging issues Matrix

	Issue identified from planning	Relevant VFM criteria	Audit response
Value for Money			
1	*Our audit fee letter, presented to the Audit Committee in June 2010, highlighted the following issues the Council was addressing through its financial management and value for money frameworks:* • *managing the financial risks across demand-led services and income streams while balancing the overall financial position* • *ensuring the medium term financial strategy remains sustainable while planning for reduced growth in resources* • *finding more innovative ways of working with strategic partners in the challenging economic climate* • *embedding the value for money framework by implementing the new Performance Management System ('Covalent') to enable the more systematic use of data and information.*	*Financial Resilience* *Financial Resilience* *Challenging VFM secured* *Challenging VFM secured*	*We reported the Council had made good progress with this challenging agenda in our annual letter in December 2010. Our conclusions at that time were based on the work we completed under the previous 'Use of Resources' assessment. We will consider the further progress made in line with the Council's priorities for 2010/11.*

Italics = reported in fee letter presented to the Audit Committee on 28 June 2010
Non-italics = new risk

	Issue identified from planning	Relevant VFM criteria	Audit response
Value for Money			
2	The Council is dealing with a difficult financial outlook and is currently reviewing its priorities and assessing its financial resilience. There are significant financial pressures as a result of the economic downturn and cost pressures arising from the increase in demand for services. Further pressures arose in the year following the Coalition Government's emergency budget, comprehensive spending review and grant settlement for 2011/12. The Council is working to secure total (revenue) savings of £23.5 million in 2011/12. Savings in the Council's capital programme amounting to £1 million are also planned. While the Council has a good track record of achieving its savings plans, there is a risk it may not be able to deliver the planned savings and efficiency improvements which may, in turn, adversely affect service delivery.	Financial Resilience	The Council's financial position will be regularly monitored during the course of our planning and audit work, and we will focus on the arrangements established and outcomes of the Council's plans for delivering efficiencies in our value for money conclusion work. We will review the Council's approach to identifying and responding to financial risks and opportunities. We will also review progress made towards efficiency plans and the financial stability of the Council over the medium term. We will also consider the extent to which financial plans support achievement of Council priorities where these have been updated in the year.
3	The total amount of general balances and reserves available (£17.1 million as at 31 March 2010) will require careful management given the significant financial risks and uncertainties the Council is facing.	Financial Resilience	We will monitor achievement of the Council's strategy for maintaining its general balances and reserves at a prudent level. We will also review the scope and extent of earmarked reserves maintained as the Council further develops its priorities.

Italics = reported in fee letter presented to the Audit Committee on 28 June 2010
Non-italics = new risk

	Issue identified from planning	Relevant VFM criteria	Audit response
Value for Money			
4	The Council is reviewing its strategic procurement arrangements to ensure value for money can be more fully evidenced from its procurement decisions.	Challenging VFM secured	We will maintain a watching brief and comment on the Council's progress in establishing enhanced strategic procurement arrangements.
5	To improve the pace of improvement in services and towards the published performance targets set for the year, the Council has taken action to: • improve the speed of completion of core assessments for children in social care and to reduce the number of children requiring Child Protection Plans for a second or subsequent time • improve the educational attainment of looked after children and other children with special needs • review those services provided to Carers and to increase the number of Adults with learning disabilities in employment • improve performance towards Housing repairs and maintenance targets and to reduce the average time taken to re-let council dwellings • improve the speed of determining entitlement to benefit; homelessness applications and reducing the number of households in temporary accommodation.	Challenging VFM secured	Our value for money conclusion work will consider the Council's progress toward its priorities and targets in 2010/11.

Appendix B: Our responsibilities

Financial statements

The Code requires us to provide an opinion on whether your financial statements "are true and fair" and have been prepared properly, in accordance with relevant legislation and applicable accounting standards.

In carrying out this work we:

- consider the extent to which your accounting and internal control systems are a reliable basis from which to prepare the accounts
- consider the robustness of your accounts preparation processes
- undertake analytical procedures, test transactions and balances and consider the adequacy of the disclosures in your financial statements.

We will consider the adequacy of your arrangements for closing down the ledger and producing accurate, timely and comprehensive financial statements and supporting working papers. We will provide officers with a detailed list of schedules and working papers required for the audit.

We will review the appropriateness and consistency of application of the accounting policies adopted by the Council and ensure that these are consistent with the *Code of Practice on Local Authority Accounting in the United Kingdom 2010/11*.

We will report to you significant qualitative aspects of the accounting practices including the application of the Code or other significant matters relevant to the financial reporting process.

We will also report uncorrected misstatements and material uncertainties relating to going concern.

We will read the other information included in the financial statements and, if appropriate the annual report, to ensure this is consistent, complete and not misleading based on our overall knowledge. We will review your annual governance statement to assess whether it has been presented in accordance with relevant guidance, is adequately supported, that an effectiveness review has been completed, and it is consistent, complete and not misleading based on our overall knowledge.

We will report to you significant matters discussed, or subject to correspondence with management or other employees; and also any significant difficulties that we encountered during the course of the audit.

We will seek written representations from the Council or from other parties to acknowledge and understand the responsibilities for preparing the financial statements, for the internal controls necessary to enable preparation of financial statements that are free from material misstatement whether due to fraud or error, and that we have been provided with access to all information of which you are aware of that is relevant to the preparation of the financial statements.

Where we propose any modifications to the audit opinion or emphasis of matter paragraphs in the auditors' report, we will report this to you along with the reasons for the modifications.

Internal controls and significant financial systems

International Standards on Auditing (UK and Ireland) require auditors to obtain a detailed understanding of an organisation, its environment, risk assessment processes, the information systems, internal controls and monitoring activities. This must be sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error and be sufficiently well documented to enable the auditor to design and perform further audit procedures based on identified risks.

Where the audit intends to rely on identified controls to reduce risk or the level of detailed testing the auditor must also undertake tests of the operating effectiveness of the relevant controls. The key financial systems upon which the accounts are based will therefore require additional testing and review in order to arrive at our opinion on the financial statements.

Your significant financial systems are:

- Main accounting
- Cash and bank
- Payments and creditors
- Income and debtors
- Payroll and employment costs
- Information technology
- Council tax
- Housing and council tax benefits
- National Non-Domestic Rates
- Housing rents income
- Investments and investment income

We will report to management any deficiencies in internal control identified during the audit. Where we identify significant deficiencies in internal control during the audit we will also report those to those charged with governance.

Working with Internal Audit

The Audit Commission expects appointed auditors and Internal Audit departments to work together to ensure that audit work is most effectively targeted in well-managed councils, thereby minimising duplication and the overall level of audit resource input.

Fraud risk assessment

We have a responsibility to consider specifically the potential risk of material misstatement of your financial statements as a result of fraud and error, including the risk of fraudulent financial reporting.

The primary responsibility for ensuring that your internal control frameworks are robust enough to prevent and detect fraud and corrupt practices lies with management and “those charged with governance” (the Audit Committee).

We will make appropriate enquiries and review the counter fraud arrangements in place in order to identify the fraud risks, and the controls you have put in place on which we will seek to place reliance to mitigate those risks.

For all fraud risks, and for any actual frauds that have been identified and we have been informed of, we will consider the possible impact on your accounts and our audit programme.

Whole of government accounts (WGA)

As part of the WGA process we are required to review and report on the consolidation pack you have prepared for submission. The actual procedures to be performed have been developed by the Audit Commission in discussion with the National Audit Office. Our work involves ensuring consistency between the audited accounts and the consolidation pack, and the agreement of balances with other bodies.

Value for money conclusion

The Code requires auditors to issue a conclusion on whether (or not) the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness. This is known as the value for money (VFM) conclusion.

The Commission has reviewed its approach to auditors' VFM work so that from 2010/11 auditors will give their statutory VFM conclusion based on the following two reporting criteria:

- the organisation has proper arrangements in place for securing financial resilience.
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The focus of the criteria for 2010/11 are:

- the organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
- the organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We will also follow up on audit work from previous years to assess progress in implementing agreed recommendations.

Local risk-based work

Local risk-based work is proposed to address audit risks relating to the accounts opinion or Value for Money Conclusion where normal levels of work are considered insufficient to fully address risk exposures. The emphasis of our work in respect of 2010/11 is set out in Appendix A.

Appendix C: Communication with those charged with governance

To: Audit Committee, Medway Council

Auditors appointed by the Audit Commission are subject to the *Code of Audit Practice* (the Code) which includes the requirement to comply with International Standards on Auditing (ISA) when auditing the financial statements. ISA (UK & Ireland) 260 – Communication with those charged with governance requires auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff.

The revised ISA does not define 'those charged with governance' as there are such a diverse range of arrangements across all types of entity. However it does state that "The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate." In the case of Medway Council it has been agreed that the appropriate addressee of communications from the auditor to those charged with governance is the Audit Committee. The auditor reserves the right, however, to communicate directly with the Council on matters which are considered to be of sufficient importance.

Auditors are required by the Code to:

- carry out their work with independence and objectivity
- exercise their professional judgement and act independently of both the Commission and the audited body
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors, or any firm with which an auditor is associated, should not carry out work for an audited body, which does not relate directly to the discharge of the auditors' functions if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired. If auditors are satisfied that performance of such additional work will not impair their independence as auditors, nor be reasonably perceived by members of the public to do so, and the value of the work in total in any financial year does not exceed a *de minimis* amount (currently the higher of £30,000 or 20% of the annual audit fee), then auditors (or, where relevant, their associated firms) may undertake such work at their own discretion. If the value of the work in total for an audited body in any financial year would exceed the *de minimis* amount, auditors must obtain approval from the Commission before agreeing to carry out the work.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The *Standing Guidance for Auditors* includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- any staff involved on Commission work who wish to engage in political activity should obtain prior approval from the Engagement Partner
- audit staff are expected not to accept appointments as lay school inspectors
- firms are expected not to risk damaging working relationships by bidding for work within an audited body's area in direct competition with the body's own staff without having discussed and agreed a local protocol with the body concerned
- auditors are expected to comply with the Commission's statements on firms not providing personal financial or tax advice to certain senior individuals at their audited bodies, auditors' conflicts of interest in relation to PFI procurement at audited bodies, and disposal of consultancy practices and auditors' independence

- auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission
- auditors are expected to comply with the Commission's policy for both the Partner and the second in command (Manager) to be changed on each audit at least once every five years
- audit suppliers are required to obtain the Commission's written approval prior to changing any Audit Partner in respect of each audited body
- the Commission must be notified of any change of second in command within one month of making the change. Where a new Partner or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.

Statement by the appointed auditor

In relation to the audit of the financial statements for Medway Council for the financial year ending 31 March 2010, we are able to confirm that the Commission's requirements in relation to independence and objectivity, outlined above, have been complied with.

Under the requirements of ISA (UK & Ireland) 260 – Communication with those charged with governance, we are not aware of any relationships that may bear on the independence and objectivity of the audit engagement partner and audit staff which are required to be disclosed.