Medway Council
Serving You

AUDIT COMMITTEE

29 MARCH 2012

EXTERNAL AUDIT ANNUAL AUDIT PLAN 2011/2012

Report 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 2011/2012.

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 2011/2012, 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 2011.

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 fee as £344,100 which is a £30,000 increase on the provisional fee presented to this committee on 29 March 2011, albeit this is offset by a reduction in the estimated fees for grant audit.

4.2 The planned fee for certification of grant claims and returns is £50,000 which represents a reduction of £30,000 (as referred to in paragraph 4.1) since PKF issued their fee letter in April 2011.

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 2011/2012 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 2011/2012.

Lead office contact

Mick Hayward, Chief Finance Officer.
Tel No: 01634 332220 Email: mick.hayward@medway.gov.uk

Background papers

The annual audit plan 2011/2012 (attached as Appendix 1)

Appendix 1

PKF

Accountants &
business advisers

Medway Council

Audit Plan 2011/12

February 2012

Contents

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 Medway Council's (the Council) accounts and to review its arrangements for securing value for money for the 2011/12 financial year. The Plan updates the fee letter discussed with the Audit Committee in April 2011 now that we have concluded our 2010/11 audit. The Plan also considers the work we have undertaken to date to liaise with officers, including the Head of Internal Audit, on the significant risks the Council is currently addressing.

1.2 In summary, the Plan is designed to:

- ensure there is a mutual understanding of the respective responsibilities relating to the audit of the financial statements
- provide you with an overview of the planned scope of the audit for the year ended 31 March 2012
- ensure that the areas of potential risk of material misstatement which we have identified are consistent with the areas which you perceive to be the key areas and to promote effective two-way communication between us.

1.3 In addition, we are required by International Standards in Auditing [ISAs (UK & Ireland)] to communicate certain matters to you in connection with our audit.

Significant risks

Financial statements

1.4 The significant risks we have identified in planning our audit of the Financial Statements are set out in detail in section 3 and Appendix A, and involve in summary:

- ensuring the effective preparation and publication of the 2011/12 financial statements
- management override of controls (this is a 'non-rebuttable' audit risk)
- revenue recognition (and the risk of fraud)
- accounting for transactions involving the 'self financing' Housing Revenue Account (significant risk accounting treatment)
- accounting for revenue Government Grants and other contributions
- weaknesses in controls operating over financial systems (and the risk of material misstatement), involving controls over the:
  - operation and maintenance of the fixed asset register
  - preparation and authorisation of schools journals
  - 'Care Director' social care system.

Value for money conclusion

1.5 The Council has continued to develop and then embed its value for money approach over the last three years. We have not identified any significant value for money risks though the reduction in Government funding, the difficult financial outlook and continuing economic pressures are examples of issues we will keep under review in completing our value for money assessment. Issues Medway is dealing with include:

- ensuring the overall financial position is balanced and that identified departmental overspends are managed effectively (a small underspend is forecast overall as at 31

December 2011 though management action continues to be taken to ensure financial balance)

- ensuring the medium term financial plan remains balanced and achievable
- achieving the outcomes expected form the Council's 'Better for Less' efficiency programme
- responding to the new legislation published by the Coalition Government (including the Localism Act, the Education Act and the Health and Social Care Bill)
- improving performance in priority areas towards the Council's published targets (in Children's and Adult Social Care services for instance).

Fees

1.6 The audit fee for the year is £344,100, which has increased by £30,000 since we issued our Audit Fee Letter to you in April 2011. Since that time, we have updated our risk assessment and increased the fee because of the:

- additional work necessary to review the Council's progress in addressing the significant matters arising from our 2010/11 audit where we identified material and other significant misstatements and concluded the financial statements production process should be improved
- 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). .

1.7 The assumptions we have made in setting the audit fee are set out in section 4.

1.8 We estimate the fee payable for the audit of the Council's grant claims and other Government returns to be £50,000. The fee is payable in addition to the audit fee highlighted above and represents a reduction of £30,000 since we issued our fee letter in April 2011.

Key outputs

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

Output	Expected timing
Accounts	
Update on the review of internal controls	June 2012
Annual governance report on the financial statements	September 2012
Audit opinion covering the financial statements	September 2012
Opinion on the Whole of Government Accounts return	September 2012
Use of resources	
Feedback to Audit Committee	September 2011
Value for money conclusion	September 2012
Annual audit letter	November 2012
Grants	
Grants report to Those Charged With Governance	February 2013

2 Introduction

2.1 This Annual Audit Plan sets out the audit work that we propose to undertake for the 2011/12 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 Our responsibilities, as auditors, in relation to the audit of the financial statements are as set out in Appendix B. We are responsible for forming and expressing an opinion on the financial statements that have been prepared by you. The audit of financial statements does not relieve you of your responsibilities.

Planned scope of the audit

2.3 We will plan and perform procedures designed to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to fraud or error, thereby enabling us to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

2.4 Our approach to the audit is risk based. We will obtain an understanding of the entity and of the environment in which it operates, including the entity's internal control and this, together with information obtained from discussions with management, provides a basis for identifying and assessing the risks of material misstatement.

Assessing risks

2.5 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.

2.6 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.

3 Risk assessment

Significant financial statement audit risks

3.1 The Council's arrangements for preparing and publishing the 2010/11 accounts deteriorated and the overall quality of the accounts reviewed by the Audit Committee and provided to external audit was lower than previous years. Material and other errors and inconsistencies were found by our audit work. An unqualified opinion was given two months after the deadline specified by the Government. The Council is implementing an improvement plan to address the weaknesses identified.

3.2 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

3.3 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.

Revenue recognition

3.4 ISA (UK & Ireland) 240 *The auditor's responsibilities in relation to fraud in an audit of financial statements* requires us to presume that there are risks of fraud in revenue recognition. These risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue. As a consequence our audit work will be designed to focus on these areas.

Housing Reform - 'Self financing' Housing Revenue Account

3.5 The Localism Act (2011) introduced the concept of the 'self-financing' Housing Revenue Account. From 1 April 2012, Councils will be able to retain all income from social housing rent and use it locally to maintain their housing stock. The development aims to establish a more predictable and stable basis for Councils to plan over the longer term.

3.6 The Government has completed a 'self-financing' valuation of each local housing authority's dwelling stock using a discounted cash flow model. The model is based on assumptions made by the Government about the rental income and expenditure required to maintain each Council's housing stock over the next 30 years. Where the self-financing valuation for a local housing authority is higher than its subsidy capital financing requirement (SCFR), the authority will pay (the Secretary of State) the amount by which the self financing valuation exceeds the SCFR. Medway is due to pay £19.144 million by 28 March 2012, being the difference between the self financing valuation (£45.846 million) and the SCFR (£26.702 million). The Council must therefore determine arrangements to resource the payment and the Treasury Management strategy has been updated accordingly.

3.7 While the transactions relating to the financing and payment of amounts to the Government are not complex, there will be an impact on the HRA capital financing requirement and the General Fund capital financing requirement. Cipfa is due to publish additional guidance on this matter. At Medway, the transactions are material and we therefore consider there is a significant audit risk in respect of compliance with accounting requirements for the HRA and the General Fund.

Government grants and other contributions (Revenue)

3.8 In 2010/11 we found the Council did not consistently account for income due from revenue government grants in the financial statements. The errors affected the overall surplus reported by the Council because income was understated (by £2.6 million) and the net cost of services overstated as at 31 March 2011. In addition, earmarked reserves were understated and current liabilities overstated by £7.1 million. The position arose mainly because of the cumulative effect of errors made in restating the 2009/10 accounts and relevant opening balances. There remains a risk the Council does not appropriately account for revenue Government Grants and other contributions in the 2011/12 financial statements and we will need to confirm the basis of such transactions accordingly.

Fixed Asset register – Property, plant and equipment and assets held for sale

3.9 The Council completed a review of arrangements for maintaining a fully functioning fixed asset register in the year. The review was necessary because of the material and other significant errors evident in accounting for fixed assets and assets held for sale in the 2009/10 (restated) and 2010/11 financial statements. Officers expect the review to be completed by March 2012 and that training will be provided (to officers) on the operation of the fixed asset register to produce materially accurate fixed asset balances and other capital accounting transactions and disclosures as at 31 March 2012.

3.10 The operation of the fixed asset register presents a significant audit risk in respect of the accuracy and completeness of information recorded throughout the year. We will also need to confirm the register is working appropriately to calculate capital charges and to support materially correct balances for property, plant and equipment, intangible assets, investment properties and assets held for sale in the financial statements.

Controls over the preparation and authorisation of journals in schools

3.11 In 2010/11 our work identified controls over the preparation and authorisation of journals in schools were inconsistently applied. Material amounts of expenditure are incurred in schools and we will review the controls operating over schools journals processed throughout 2011/12 to establish whether such controls can be relied upon. Where necessary, we will undertake additional, substantive audit procedures.

Care Director (Social Care Income and Expenditure) financial system

3.12 Working with Internal Audit, we identified controls operating within the Care Director system (which calculates social care income and expenditure) did not operate effectively throughout 2010/11. We therefore completed additional audit work to confirm amounts produced by the system as at 31 March 2011 were materially correct. The lack of effective controls presents a significant audit risk in respect of the accuracy and completeness of amounts included in the financial statements. We have therefore planned to undertake additional, substantive audit procedures on the balances produced by the system as at 31 March 2012.

Other issues relevant to the audit of the financial statements

3.13 In addition to the significant risks highlighted above, we have identified a number of issues relevant to our audit of the 2011/12 financial statements where additional audit procedures will be undertaken, as summarised below.

Changes to Financial Controls – Housing and Council Tax Benefit assessment and administration of Council Tax National Non-Domestic Rates (NNDR)

3.14 On 23 January 2012, the Council introduced new management arrangements for the assessment and award of housing and council tax benefit, council tax amounts and the administration of council tax and National Non-Domestic Rates (NNDR), with the 'Customer Contact' department taking on responsibility for these services. While the benefits manager is expected to retain responsibility for checking the work of assessors and completing monthly financial reconciliations, it is expected that the supervisor role previously undertaken by departmental managers over the work of benefit (and council tax and NNDR) assessors will be removed. It is also expected individual staff will undertake wider responsibilities to administer all types of benefit, council tax and NNDR transactions (including the award of single person's discount and NNDR relief). The Head of Benefits will have no line management responsibilities over staff working in the 'Customer Contact' department and the overall level of management review of assessors' work, and in particular the management review of the more complex benefit claims and NNDR cases, may reduce.

3.15 The new management arrangements will be introduced during the course of the financial year and material amounts of benefit expenditure, council tax and NNDR income are likely to be administered between 23 January and 31 March 2012. We will also need to work with Internal Audit to document and test the controls operating throughout the year, including the controls and management checks implemented after 23 January.

Changes to the 2011/12 IFRS Code of Practice

3.16 Cipfa has published the guidance notes accompanying the 2011/12 Code of Practice. No significant changes are proposed in the year though additional guidance relevant to Medway's accounts includes:

- the impact of adopting FRS 30 (Heritage assets)
- accounting for and disclosure of business rates supplements
- new guidance on accounting for the Community Infrastructure Levy (CIL)
- additional guidance on the definition of a related party
- a requirement to disclose the number and cost of exit packages.

3.17 We will review the Council's implementation of the new requirements specified by the Code

Whole of Government Accounts (WGA)

3.18 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 financial statements and the consolidation pack, and the agreement of balances with other bodies. We have not identified any significant risks in the Council's arrangements for preparing the WGA and will liaise with officers on any relevant matters arising from our audit of the 2011/12 financial statements.

Working with Internal Audit

3.19 As in previous years, we have discussed the scope and extent of internal and external audit work planned at Medway with the Head of Internal Audit to avoid overlap and duplication. The Internal Audit section plans to review the following financial systems based on the capacity it has available in the year:

- Housing Benefits
- Council Tax
- General Ledger
- Housing Rents
- Debtors
- Cash and Bank
- National non-Domestic Rates

3.20 We will therefore review the following financial systems in detail:

- ICT
- Treasury Management
- Payroll
- Creditors
- Care Director (see paragraph 3.12)
- New Benefits; Council Tax and NNDR administration system (see paragraph 3.13)

3.21 Because the scope of detailed work to be undertaken by PKF is wider in scope than previous years, we have increased the planned audit fee.

Updated value for money conclusion risk assessment

3.22 We have updated our use of resources risk assessment for 2011/12 to take into account the

- matters arising from the completion of the 2010/11 audit
- additional audit knowledge gained since our initial risk assessment which was included in our 2011/12 Audit Fee Letter, presented to the Audit Committee in April 2011.

3.23 The table below sets out the significant issues identified from our updated risk assessment.

Issue	Planned work
Financial Resilience	
Financial Control	
The Chief Finance Officer has identified the risk expenditure pressures in the Children's Services and Adult Social Care departments may result in departmental overspends overspend by 31 March 2012. While management action is underway to address the situation, and a balanced financial position forecast as at 31 March 2012, there remains a risk an overspend may be reported for the year.	Our review of financial resilience will consider the Council's achievement of corporate and departmental budgets in the year.
Financial Planning (Medium Term)	
The Council determined a balanced budget for 2011/12 and anticipates the 2012/13 budget gap previously identified has been addressed. However, the overall financial position will require careful management because the Council's reserves may not be sufficient to sustain future expenditure plans in the event savings from the corporate efficiency programme are not fully achieved.	Our review of financial resilience will consider the sustainability of the Council's financial plans.

Issue	Planned work
Economy; Efficiency and Effectiveness	
Productivity and Efficiency	
The Council has identified risks to achieving the outcomes expected from the 'Better for Less' efficiency programme, including the need achieve planned savings and to successfully manage the transition to new ways of working (in the benefits service for instance).	Our review of economy, efficiency and effectiveness will consider the Council's progress towards its published efficiency programme.
The Council must continue to respond effectively (with partners as appropriate) to new and emerging legislation (including the Localism Act, the Education Act and the Health and Social Care Reform Bill).	Our review of economy, efficiency and effectiveness will consider the Council's response to new and emerging legislation as published by the Coalition Government..
The Council has identified some of its targets in the priority areas of Children's and Adult Social Care may not be achieved. The Council may not fully evidence value for money is secured in delivering such services.	Our review of economy, efficiency and effectiveness will consider the Council's progress towards its priorities.

4 Fees

4.1 The audit fee proposed for the year is £344,100, which has increased by £30,000 since we issued our Audit Fee Letter to you in April 2011. It has been necessary to increase the fee because of the significant matters identified by our audit of accounts in 2010/11 which the Council may not have fully resolved in 2011/12. The additional risk-based work we propose involves working with the Finance Team throughout the closure of accounts process.

4.2 In addition, the Internal Audit Section does not have sufficient resources available to review all material financial systems. In 2011/12, the section plans to review the Housing Benefits; Council Tax; General Ledger; Housing Rents; Debtors; Cash and Bank; National non-Domestic Rates systems. PKF will need to undertake detailed work across all residual financial systems as summarised at paragraph 3.20. The situation represents additional external audit work compared to previous years.

4.3 The proposed revised fee is summarised below.

Audit area	Actual Fee 2010/11	Audit Fee Letter 2011/12	Revised Fee 2011/12
	£	£	£
Financial statements including WGA	239,000	235,000	235,000
Value for money conclusion	110,000	79,100	79,100
Audit Commission Scale Fee	**£349,000**	**£314,100**	**£314,100**
Additional Fee: audit of 2010/11 statements)	50,000	0	0
Risk Based work 2011/12:			
• Financial Statements Risks	0	0	20,000
• Review of financial systems	0	0	10,000
Total Code Audit fee	**£399,000**	**£314,100**	**£344,100**
Audit Commission Rebate	£(34,200)	TBA	TBA
Certification of claims and returns (Estimated – see comments below)	58,002	80,000	50,000
Grant claims report to those charged with governance	2,000	2,000	2,000

4.4 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 Financial Officer and then prepare a report outlining the reasons why the fee needs to change for discussion with the Audit Committee.

4.5 As well as the audit fee of £344,100 identified above, the following fees are separately billable:

Questions and objections

4.6 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

4.7 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.

4.8 Grant fees for claims and returns for the year ended 31 March 2011 have been completed. The outturn fee was £58,002 which was significantly below our estimate of £80,000 because we were able to rely on the review of housing and council tax benefit claims completed by the external contractors appointed by the Council. The fee for the audit of the benefit subsidies claim therefore reduced by about £25,000 in 2010/11. The Council is planning to use the external contractors to undertake work on the 2011/12 benefit subsidies claim and we will plan our work accordingly. We anticipate a further reduction in the fee for grant claims in 2011/12 to £50,000. A further £2,000 is payable for the report on the Council's arrangements for preparing grant claims to the Audit Committee which is an Audit Commission requirement. 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 so that we are able to place full reliance on this work
- external contractors will complete the detailed review of housing and council tax benefit cases in accordance with agreed plans and we will fully rely on the work produced
- you will keep us informed of any significant changes to your main financial systems, procedures or internal controls
- you will provide the information requested in our records required listing in accordance with the agreed timetable and that there will be no significant departures from the timetable.
- you will ensure that 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.

4.9 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 2011/12 and our consideration of your annual governance statement in your 2010/11 accounts.

Billing arrangements

4.10 Your audit fee is being billed as shown below:

Month	£
June 2011	78,500
September 2011	78,525
December 2011	82,250
March 2012	104,825
Total	**£344,100**

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.
Engagement Manager Kerry Barnes Email: kerry.barnes@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 VFM conclusion work and for completion of the Audit Plan, Annual Governance Report and Annual Audit Letter.
Supervisor Richard Bennett Email: richard.bennett@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.
VFM Auditor Colin Foster Email: colin.foster@uk.pkf.com Tel: 020 7065 0000	Responsible for assessing the Council's VFM 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 2012
Accounts – financial statements	July - August 2012
Opinion on the Whole of Government Accounts return	July – August 2012
Value for money – specific risks	September 2011 - September 2012
Value for money conclusion	September 2012
Grants reviews (including HBCOUNT benefits work)	June to November 2012
Annual audit letter	October 2012
Grants report for claims and returns for the year ended 31 March 2012	February 2013

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

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. We will communicate matters of governance interest that have come to our attention as a result of the performance of the audit. The audit is not designed to identify all matters that may be relevant to you. Communication may take the form of discussions or, where appropriate, be in writing.

5.5 If we identify significant deficiencies in internal control, we will communicate such deficiencies to you, in writing, as soon as is practicable.

5.6 Our contact for communications will be the Chief Financial Officer and then the Audit Committee. Our communications will consider all individuals representing those charged with governance as informed and our responsibilities for communicating relevant matters will be discharged.

5.7 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.

Findings from the audit

5.8 We will communicate the following matters to you, where applicable:

- significant deficiencies in internal control identified during the audit
- significant qualitative aspects of the entity’s accounting practices including the application of the applicable financial reporting framework
- significant matters discussed, or subject to correspondence with management or other employees
- uncorrected misstatements
- material misstatements that have been corrected by management
- other significant matters relevant to the financial reporting process
- material uncertainties relating to going concern
- written representations that we are requesting from you or from other parties
- expected modifications to the opinion or emphasis of matter (or other matter) paragraphs in the auditor’s report
- significant difficulties that we have encountered during the course of the audit.

Materiality

5.9 Materiality is the expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. In carrying out our work we will apply an appropriate level of materiality and as such the audit cannot be relied upon to identify all potential or actual misstatements.

Uncorrected misstatements

5.10 We will report to you all uncorrected misstatements that relate to the current financial year (including those arising in previous periods that have an effect on the current year financial statements) and the effect that they have individually, or in aggregate, on the opinion in the auditor's report except for those that are clearly trivial. For reporting purposes, we consider misstatements of less than £130,000 to be trivial, unless the misstatement is indicative of fraud.

5.11 We will identify material uncorrected misstatements individually. We will request that any uncorrected misstatements be corrected.

Independence and objectivity

5.12 Auditors appointed by the Audit Commission are subject to the Code of Audit Practice and Standing Guidance for Auditors which include the requirement to comply with the International Standards on Auditing (ISA). ISA (UK and Ireland) 260 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.

5.13 In relation to the audit of the financial statements for Medway Council for the financial year ending 31 March 2012, we are able to confirm that the Audit Commission's requirements in relation to independence and objectivity have been complied with.

5.14 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.

Quality of service

5.15 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 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.

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

5.17 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 their website http://www.audit – commission.gov.uk/complaints/

Appendix A

Value for money risk assessment matrix

	Audit issue identified from planning	Relevant UoR criteria	Audit response
Use of Resources			
1	The Chief Finance Officer has identified the risk expenditure pressures in the Children's Services and Adult Social Care departments may result in departmental overspends overspend by 31 March 2012. While management action is underway to address the situation, and a balanced financial position forecast as at 31 March 2012, there remains a risk an overspend may be reported for the year.	Financial Resilience (Financial Control)	Our review of financial resilience will consider the Council achievement of corporate and departmental budgets in the year. We will liaise with the Chief Financial officer to review the effectiveness of management action in addressing the identified overspends on departmental budgets.
2	The Council determined a balanced budget for 2011/12 and anticipates the 2012/13 budget gap previously identified has been addressed. However, the overall financial position will require careful management because the Council's reserves may not be sufficient to sustain future expenditure plans in the event savings from the corporate efficiency programme are not fully achieved.	Financial Resilience (Financial Planning)	Our review of financial resilience will consider the sustainability of the Council's financial plans.
3	The Council has identified risks to achieving the outcomes expected from the 'Better for Less' efficiency programme, including the need achieve planned savings and to successfully manage the transition to new ways of working (in the benefits service for instance).	Economy; Efficiency and Effectiveness (Productivity and Efficiency)	Our review of economy, efficiency and effectiveness will consider the Council's progress towards its published efficiency programme.
4	The Council must continue to respond effectively (with partners as appropriate) to new and emerging legislation (including the Localism Act, the Education Act and the Health and Social Care Reform Bill).	Economy; Efficiency and Effectiveness (Productivity and Efficiency)	Our review of economy, efficiency and effectiveness will consider the Council's response to new and emerging legislation as published by the Coalition Government..
5	The Council has identified some of its targets in the priority areas of Children's and Adult Social Care may not be achieved.	Economy; Efficiency and Effectiveness (Prioritising Resources)	Our review of economy, efficiency and effectiveness will consider the Council's progress towards its priorities.

Accounts risk assessment matrix

	Audit risk identified from planning	Financial Statement Area & Assertion	Audit response
Accounts			
1	**Preparation and publication of financial statements** The Council's arrangements for preparing and publishing the 2010/11 accounts deteriorated and the overall quality of the accounts provided to external audit was lower than previous years. Material and other errors and inconsistencies were found by our audit work.	All Areas of Financial Statements Completeness Existence/Occurrence Accuracy Cut-Off Valuation Rights and Obligations	The Council is implementing a detailed improvement plan and the Audit Committee continues to receive reports on progress. We are working with the Finance Team throughout the closedown process.
2	**Management override** 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.	All Areas of Financial Statements Completeness Existence/Occurrence Accuracy Cut-Off Valuation Rights and Obligations Classification	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	**Revenue recognition** ISA (UK & Ireland) 240 The auditor's responsibilities in relation to fraud in an audit of financial statements requires us to presume that there are risks of fraud in revenue recognition.	All Areas of Financial Statements Completeness Existence/Occurrence Accuracy Cut-Off Valuation Rights and Obligations Classification	Revenue recognition risks may arise from the use of inappropriate accounting policies, failure to apply the Council's stated accounting policies or from an inappropriate use of estimates in calculating revenue. As a consequence our audit work will be designed to focus on these areas.

	Audit risk identified from planning	Financial Statement Area & Assertion	Audit response
Accounts			
4	**'Self financing' Housing Revenue Account** The Secretary of State has notified Medway it should pay £19.144 million by 28 March 2012, being the difference between the self financing valuation (£45.846 million) and the SCFR (£26.702 million). The Council must therefore determine how the amount is resourced and the Treasury Management strategy is being reviewed accordingly.	We will review appropriateness of accounting treatment based on Cipfa guidance	We will discuss with officers the transactions involved in finalising the payments to the Government in respect of the Council's housing stock valuation in planning our audit of the financial statements.
5	**Government grants and other contributions (Revenue)** In 2010/11 we found the Council did not consistently account for income due from revenue government grants in the financial statements. The errors affected the overall surplus reported by the Council because income was understated (by £2.6 million) and the net cost of services overstated as at 31 March 2011. In addition, earmarked reserves were understated and current liabilities overstated by £7.1 million.	CIES and Balance Sheet Completeness Existence/Occurrence Accuracy Cut-Off Rights and Obligations	The position arose mainly because of the cumulative effect of errors made in restating the 2009/10 accounts and relevant opening balances. There remains a risk the Council does not appropriately account for Government Grants and other contributions in the 2011/12 financial statements and we will need to confirm the basis of such transactions accordingly.
6	**Fixed Asset register – Property, plant and equipment and assets held for sale** The Council completed a review of arrangements for maintaining a fully functioning fixed asset register in the year. The review was necessary because of the material and other significant errors evident in accounting for fixed assets and assets held for sale n the 2009/10 (restated) and 2010/11 financial statements. Officers expect the review to be completed by March 2012 and that training will be provided (to officers) on the operation of the fixed asset register to produce materially accurate fixed asset balances and other capital accounting transactions and disclosures as at 31 March 2012.	Valuation and completeness of property, plant and equipment, intangible assets and assets held for sale	The operation of the fixed asset register presents a significant audit risk in respect of the accuracy and completeness of information recorded throughout the year. We will also need to confirm the register is working appropriately to calculate capital charges and to support materially correct balances for property, plant and equipment, intangible assets, investment properties and assets held for sale in the financial statements.

	Audit risk identified from planning	Financial Statement Area & Assertion	Audit response
Accounts			
7	**Controls over the preparation and authorisation of journals in schools** In 2010/11 our work identified controls over the preparation and authorisation of journals in schools were inconsistently applied.	CIES and Balance Sheet Completeness Existence/Occurrence Accuracy Cut-Off	Material amounts of expenditure are incurred in schools and we will review the controls operating over schools journals processed throughout 2011/12 to establish whether such controls can be relied upon. Where necessary, we will undertake additional, substantive audit procedures.
8	**Care Director (Social Care Income and Expenditure) financial system** Working with Internal Audit, we identified controls operating within the Care Director system (which calculates social care income and expenditure) did not operate effectively throughout 2010/11. We therefore completed additional audit work to confirm amounts produced by the system as at 31 March 2011 were materially correct.	CIES and Balance Sheet Completeness Existence/Occurrence Accuracy Cut-Off Rights and Obligations	The lack of effective controls presents a significant audit risk in respect of the accuracy and completeness of amounts included in the financial statements. We have therefore planned to undertake additional, substantive audit procedures on the balances produced by the system as at 31 March 2012.

Other issues relevant to the audit of the financial statements

	Audit issue identified from planning	Financial Statement Area	Audit response
Accounts			
1	**Changes to Financial Controls – Housing and Council Tax Benefit assessment, administration of Council Tax and National Non-Domestic Rates (NNDR)** On 23 January 2012, the Council introduced new management arrangements for the assessment and award of housing and council tax benefit and the administration of National Non-Domestic Rates (NNDR), with the 'Customer Contact' department taking on responsibility for these services. While the benefits manager will retain responsibility for checking the work of assessors and completing monthly financial reconciliations, it is expected that the supervisor role previously undertaken by departmental managers over the work of benefit (and council tax and NNDR) assessors will be removed. It is also expected individual staff will undertake wider responsibilities to administer all types of benefit and NNDR transactions (including the award of council tax discount and NNDR relief). The Head of Benefits is expected to have no line management responsibilities over staff working in the 'Customer Contact' department and the overall level of management review of assessors' work, and in particular the management review of the more complex benefit claims and NNDR cases, will reduce.	We will consider the extent of reliance on controls established by the Council.	New management arrangements are due to be introduced during the course of the financial year and material amounts of benefit expenditure, single persons discount and NNDR income are likely to be administered between 23 January and 31 March 2012. We will also need to work with Internal Audit document and test the controls operating throughout the year, including the controls and management checks implemented after 23 January.
2	**Changes to the 2011/12 IFRS Code of Practice** Cipfa has published the guidance notes accompanying the 2011/12 Code of Practice. No significant changes are proposed in the year though additional guidance relevant to Medway's accounts includes: • the impact of adopting FRS 30 (Heritage assets) • accounting for and disclosure of business rates supplements • new guidance on accounting for the Community Infrastructure Levy (CIL) • additional guidance on the definition of a related party • disclosure of the number and cost of exit packages.	Appropriateness of accounting entries related to the changes.	We will review the Council's implementation of the new requirements specified by the Code

Appendix B: Audit requirements

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.

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.

We will report to you significant aspects of the accounting practices adopted by the Council, including the application of the Code and 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 Statement of Accounts 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 responsibilities for preparing the financial statements, for the internal controls necessary to enable preparation of the 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 auditor’s 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
- Housing Rents
- Income and debtors
- Payroll and employment costs
- Council Tax
- National Non Domestic Rates
- Housing and Council Tax Benefits
- Information technology
- Care Director (Social Care)

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

Working with Internal Audit

In order to achieve an efficient and cost effective audit, we aim to work closely with Internal Audit and to effectively target work and minimise duplication and the overall level of audit resource input.

We have planned the audit on the basis that we will be able to place full reliance on the work of Internal Audit and that its work will be directed to each of the key financial systems noted above.

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 financial statements and our audit programme.

Assessment of compliance with laws and regulations risks

We have a responsibility to consider specifically the potential risk of material misstatement of your financial statements as a result of significant financial transactions that are outside of the powers available to the Council.

The primary responsibility for compliance with relevant laws and regulations is with management and those charged with governance, which will include establishing internal controls to ensure that statutory powers are available to support all significant transactions and actions of the Council.

We will review the internal controls in place and take reasonable steps to inform ourselves of significant financial transactions that are unusual or of questionable legality.

Planned audit approach

Our audit assurance will be derived from a combination of our review of the effectiveness of internal controls (see above) and further substantive audit procedures such as analytical review and detailed tests of transactions and balances where appropriate.

Analytical procedures will focus on the relationship of transactions and balances to supporting evidence and on the reported performance for the year compared to the annual budget, including review of variances where appropriate.

Depending on the nature of the risk of misstatement of classes of transactions and balances, taking into account the strength of internal controls, we will test a sample of transactions for agreement to underlying evidence provided by third-parties and management. This will include a review of the assumptions applied in assessing the financial impact from uncertainties and estimation.

Additional audit effort and procedures will be directed to areas of greater risk such as higher value items, and items subject to a greater degree of uncertainty or estimation.

Reliance on experts and others

Where the financial statements or disclosures include amounts derived from information or estimates provided by experts, the auditor may seek to place reliance on that work in obtaining audit evidence. As part of our work we expect to obtain assurance on the work undertaken by the following management's experts:

- Hyman's Robertson, the Kent Pension Fund's actuary, for valuation of the pensions liability and provision of pension fund disclosures
- Sector, the Council's treasury management advisers, for valuation of financial instruments

Whole of Government Accounts

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 financial statements 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 the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

This is 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 2011/12 is:

- 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 plan a programme of value for money audit work based upon our risk assessment.