



PUBLIC SECTOR

# Lancaster City Council

Financial Statements Audit Plan 2010/11

23 February 2011

AUDIT

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This report is addressed to the Council and has been prepared for the sole use of the Council. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Steve Clark who is the engagement lead to the Council, telephone: 0113 231 2910, email: stephen.clark@kpmg.co.uk who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 236 4000, email trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure.

Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by e mail to: complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421

# Summary

## Our audit is divided into:

- use of resources; and
- financial statements.

This document describes how we will deliver our audit work for Lancaster City Council.

Our statutory responsibilities and powers are set out in the Audit Commission Act 1998, the Local Government Act 1999 and the Audit Commission's *Code of Audit Practice (the Code)*.

The Audit Commission's Code summarises our responsibilities into two objectives, requiring us to review and report on your:

- *financial statements (including the Annual Governance Statement)*: providing an opinion on your accounts; and
- *use of resources*: concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The Audit Commission's Statement of Responsibilities of Auditors and Audited Bodies sets out the respective responsibilities of the auditor and the Council. The table below summarises the work we will do this year.

Our Responsibility	Risks, Proposed work and output
<p><b>Financial Statements and Annual Governance Statement</b></p>	<p>Our audit work is based on an assessment of risk. The key risks we have currently identified are:</p> <ul style="list-style-type: none"> <li>● <b>Medium Term Financial Plan (MTFP)/Financial Standing</b>: The Council will need to give careful consideration to its MTFP especially in light of the CSR which will require the Council to make significant savings. The Council has plans to set a balanced budget for 2011/12. If the budget is delivered, along with all of the planned savings, the Council would realise a contribution to balances of £500k. However, 2012/13 and 2013/14 will be tougher with a need to identify savings of £921k and £657k, respectively.</li> <li>● <b>Implementation of International Financial Reporting Standards (IFRS)</b>: All local authorities are required to implement IFRS in 2010/11, including restating prior period figures. This will result in some fundamental differences in accounting and will require significant planning to ensure your financial statements reflect the new standards (see page 7 for more details).</li> <li>● <b>Contingent liabilities</b>: the Council needs to reflect the latest position in relation to these events surrounding Luneside East, to ensure the financial statements are not significantly mis-stated.</li> <li>● <b>Shared Services</b>: the Council must ensure it manages the use of the Shared Services centre for Benefits and Revenues effectively to realise the efficiencies this is planned to bring.</li> </ul> <p>Our work will encompass:</p> <ul style="list-style-type: none"> <li>● Review of the controls over the completion of the accounts, relying on Internal Audit wherever possible to avoid duplication.</li> <li>● A detailed audit of the financial statements, associated disclosure notes and the Annual Governance Statement.</li> <li>● Review of the key risks identified, addressed through our detailed audit work and discussions with senior finance officers.</li> </ul> <p><b><i>The findings of this work will support the audit opinion that we issue on your financial statements.</i></b></p>

# Summary (continued)

Our audit is divided into:

- use of resources; and
- financial statements.

This document describes how we will deliver our audit work for Lancaster City Council.

Our Responsibility	Risks, Proposed work and output
<p><b>Use of Resources / Value for Money work</b></p>	<ul style="list-style-type: none"> <li>• In response to the changing financial environment, the Audit Commission has introduced a new approach to local value for money (VFM) work at those bodies previously subject to a use of resources (UoR) assessment. The new, more focused approach could reduce the work auditors do to meet their statutory VFM responsibilities.</li> </ul> <p>Our work will encompass:</p> <ul style="list-style-type: none"> <li>• A risk assessment to identify the required amount and focus of local VFM work.</li> <li>• Where applicable, undertaking local VFM work to address the risks identified in the risk assessment.</li> </ul> <p><b><i>The findings of this work will inform our value for money conclusion.</i></b></p>

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary. The remainder of this document provides details of our risk assessment, proposed work and fees for our work on the financial statements audit. It supplements the high level audit plan presented in 2010. We will provide further details separately on our VFM audit work.

# Audit overview

**We undertake our work on your financial statements and Annual Governance Statement (AGS) in four key stages.**

**Our work results in our audit opinion on your financial statements.**

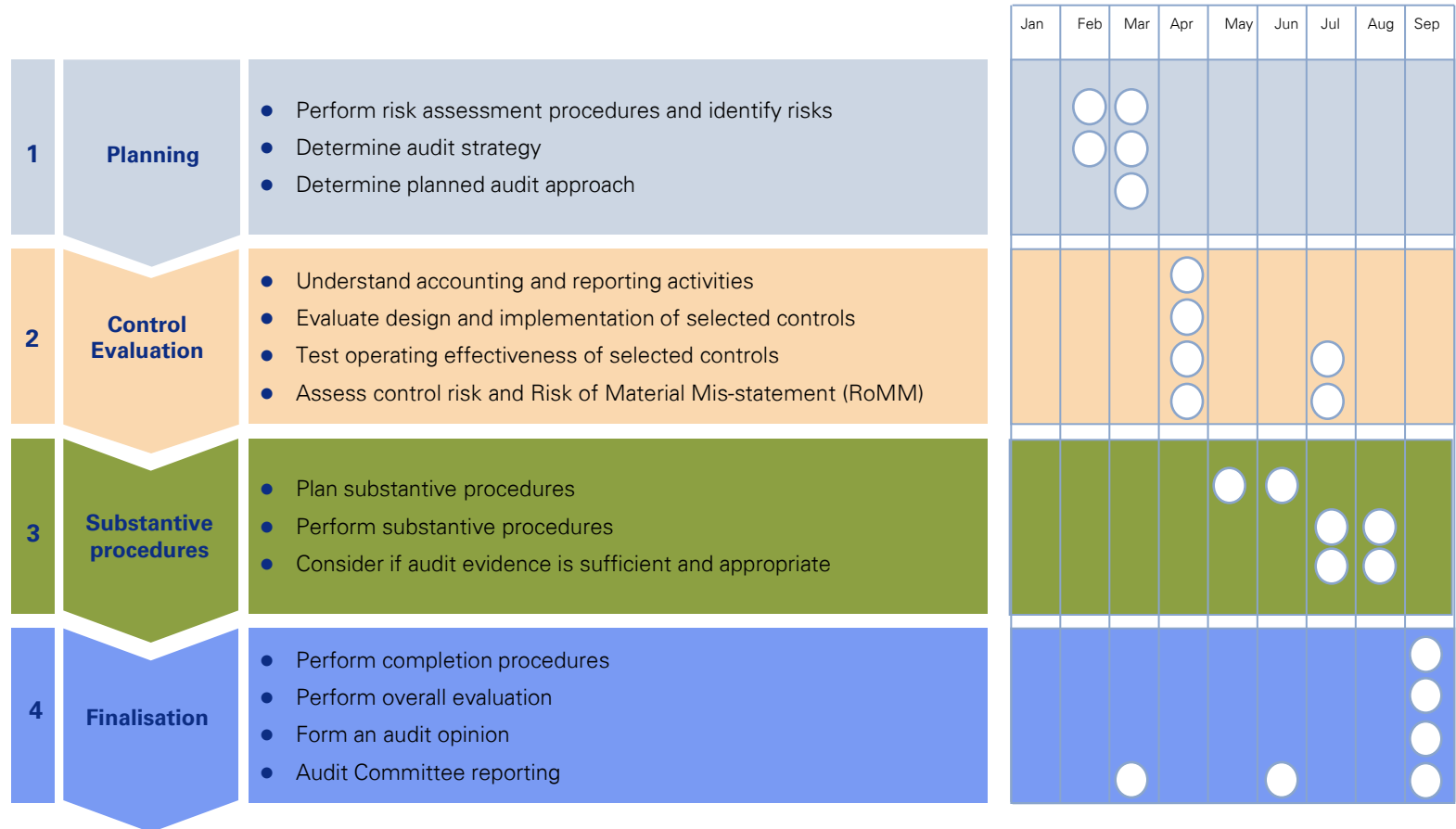
We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We are required to provide an audit opinion on the accounts.

We are also required to satisfy ourselves that your Annual Governance Statement (AGS) is consistent with our understanding of your operations. Our review of the work of Internal Audit and consideration of your risk management and governance arrangements are key to this opinion.

In addition to the Council's financial statements, we are also required to audit and provide an opinion on the Whole of Government Accounts return submitted to central government.

## Our Audit Process

We have summarised the four key stages of our financial statements audit process for you below:



# Audit overview (continued)

**We work with your Finance Team and Internal Audit team to enhance the efficiency of the accounts audit.**

## **Our Audit Process (continued)**

As part of our audit process, we will work closely with the Finance Team to understand and continually improve the accounts production process. At the planning stage of our audit we will issue the Council with a 'prepared by client' list which will include a detailed schedule of information requests to support the financial statements.

Our audit procedures also include an assessment of your arrangements to deliver your responsibilities to prevent and detect fraud. The auditing standard for fraud, ISA240 (revised), responds to the increased sensitivity to fraud and the importance given to auditors' work on fraud. Additionally, the Fraud Act 2006 and the Government Review of Fraud 2006 may impact on your responsibilities to manage fraud.

## **Liaising with Internal Audit**

We have a strong working relationship with Internal Audit and we will continue to work closely with them to maximise the use of their work on core financial systems and governance at the Council.

## **International Financial Reporting Standards (IFRS)**

All local authorities are required to implement IFRS for 2010/11 financial statements. This replaces the current practice of reporting under UK GAAP (Generally Accepted Accounting Practices). We will continue to work closely with the Finance Team to ensure the smooth transition to IFRS. We will audit the restated 2009/10 balances prior to the final visit in order to provide early assurance on key aspects of your IFRS migration work and identify any issues on a timely basis. This will also ensure some accounting and audit effort is brought forward to alleviate the busy closedown and final accounts audit season.

To prepare for the implementation of IFRS we have been discussing the Council's progress with the Accountancy Services Manager and the Head of Financial Services. We have given them guidance where requested and will review their workings in relation to this during February 2011. This will ensure that any issues arising in the restatement of prior year balances are resolved prior to the final audit.

## **Whole of government accounts (WGA)**

KPMG are required to review and report on your WGA consolidation pack in accordance with the approach agreed with HM Treasury and the National Audit Office. The 2010/11 WGA consolidated pack will need to be produced in accordance with the International Financial Reporting Standards (IFRS).

## **National Fraud Initiative**

The Council participates in the National Fraud Initiative, which is the Audit Commission's computerised data matching exercise designed to detect fraud perpetrated against public bodies. During our audit we will review the Council's progress and actions in following up the matches identified.

## **Elector Challenge**

The Audit Commission Act 1998 gives electors certain rights. These are:

- the right to inspect the accounts;
- the right to ask the auditor questions about the accounts; and
- the right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on any elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised. The costs incurred in responding to questions or objections raised by electors are not covered by our audit fee. This work will be charged in accordance with the Audit Commission's fee scales.

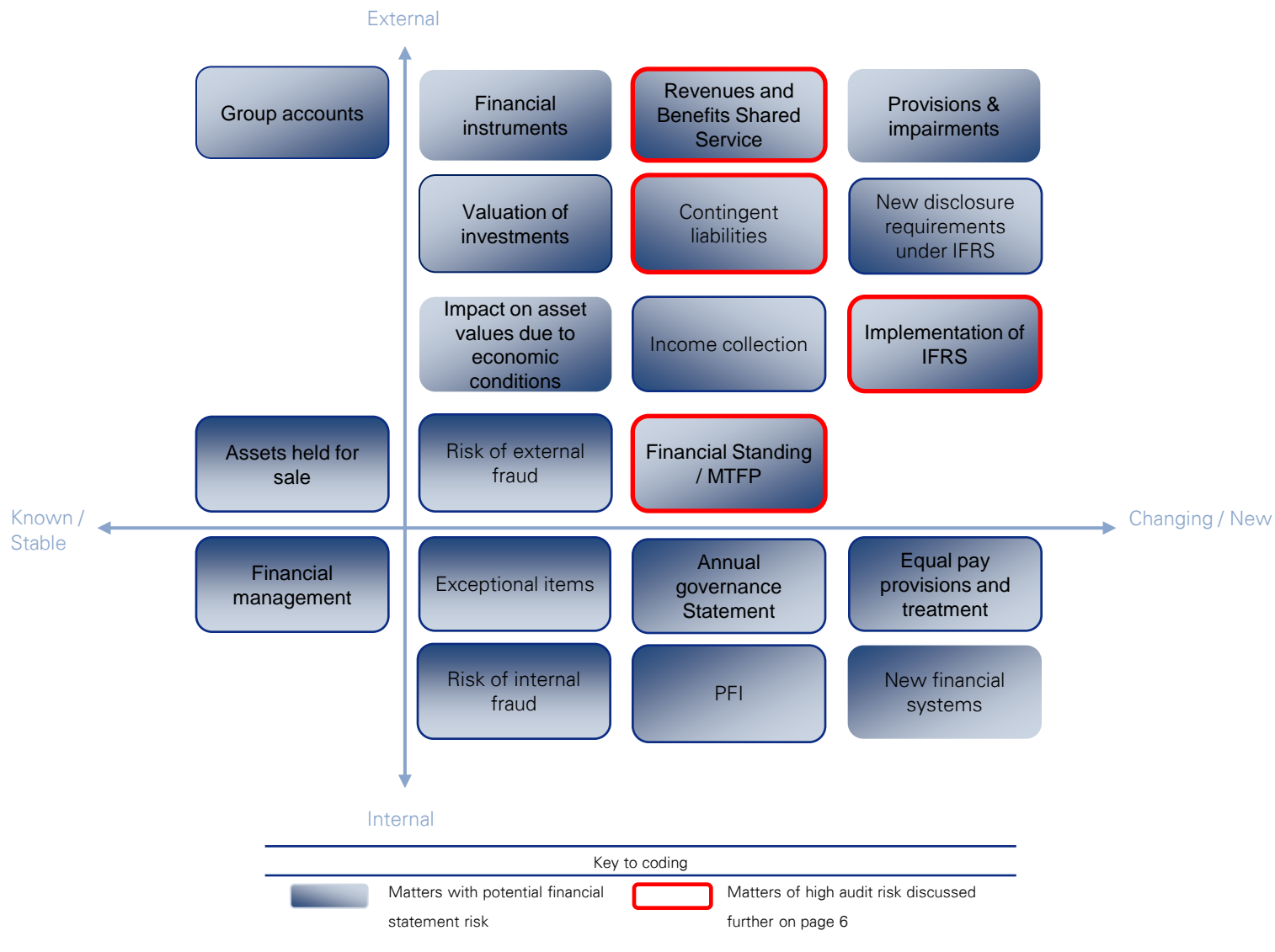
Over the last two years we have carried a number of pieces of work in response to questions/issues raised by electors.

# Key financial statement audit risks

These are the key financial statement risks identified for 2010/11 and some examples of other risks that we will consider during the audit. We seek to tailor our audit approach to reflect this risk assessment.

We have identified high audit risk in the following areas:

- Implementation of IFRS
- Contingent Liabilities
- Financial Standing/MTFP
- Revenues and Benefits Shared Service



# Key financial statement audit risk - IFRS

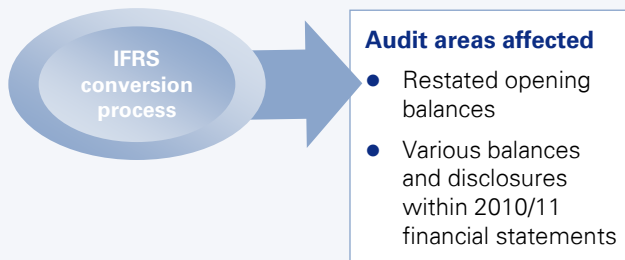
For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

The key risks identified are:

- the Council's Medium Term Financial Planning and Financial Standing;
- the Council's transition to IFRS;
- 

## Key audit risks



## Impact on audit plan

### Financial Standing / MTFP

- Linking with our value for audit work, we will consider the Council's general financial standing and in particular its approach to medium term financial planning.
- This is of particular importance following the Comprehensive Spending Review which will require the Council to make significant cost savings over the next four years. The Council needs to save £912k in 2012/13 and £657k in 2013/14 in order to set a balanced budget.
- The Council has planned, as part of its budget setting process, to contribute £500k to balances in 2011/12. This is due to the savings identified, including its early implementation of the senior management restructure and its use of a Shared Service for revenues and benefits.
- We will consider the potential impact of the outcome from this work on our financial statements audit.

### IFRS conversion process

For the year ended 31 March 2011 local authorities are required to implement IFRS.

### Impact of conversion process

- The Council has been following a conversion plan and has a project team to assist in achieving a smooth transition to IFRS.
- The IFRS conversion process is being led by the Accountancy Services Manager at the Council with his team preparing many of the working papers supporting the transition. The Council has ensured that relevant services have input into the process, for example Property Services.
- We have maintained a continuous dialogue with the Council on its progress.

### Our audit work

- We will audit the re-stated 2009/10 financial statement figures in February. During this time we will review the restated balances and working papers to ensure compliance with the CIPFA Code.
- We will discuss any issues arising with officers.
- During the final accounts audit we will audit the financial statements in line to ensure that they are in compliance with IFRS.

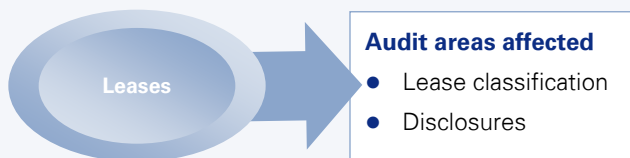


# Key financial statement audit risk – IFRS (continued)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

## Key audit risks



## Impact on audit plan

### Leases

#### Impact of IAS 17

- The impact of IAS 17 generally is that there is an increased number of finance leases as IAS 17 gives a broader definition of finance leases than the UK standard. This results in more assets coming on to balance sheet.
- The Council has reviewed its lease register and its general ledger to ascertain there is a complete record of all leases. It has then considered the treatment of these leases against the criteria of IAS 17. The Council believes that there are no additional finance leases as a result of IFRS.

#### Our audit work

- During the restatement audit we will assess the Council's process for ensuring that there is a complete record of all leases.
- We will also review all material leases and contracts to determine whether they have been correctly treated as an operating lease or finance lease under IAS 17 following the Council's assessment of its lease arrangements.

### Employee benefits

#### Impact of IAS 19

- A new liability will be recognised on the balance sheet where there is a requirement to pay wages and salaries, bonuses and holiday pay.
- At present the Council has prepared an accrual for employee benefits based on accrued annual leave and accrued flexi-time. This information has been collected for the separate service areas and the expenditure recorded in each of the relevant services.

#### Our audit work

- During the audit of the re-stated 2009/10 balances we will assess the Council's process for calculating the employee benefit and need.
- We will also audit the balance using the data collated by the Council to ensure it is line with the requirements of the standard.

# Key financial statement audit risk – IFRS (continued)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

## Key audit risks



## Impact on audit plan

### Property, plant and equipment

#### Expected impact of IAS 16

- Local authorities are to component account for any additions or valuations on or after 1 April 2010. This means when an item of property, plant and equipment comprises individual components for which significantly different depreciation methods or rates are appropriate each component is accounted for separately. For example, a house will be split between structure, roof, windows and any other significant components.

#### Our audit work

- During the interim visit we will assess the controls in place to ensure that additions/valuations are being addressed as components and appropriately recorded in the fixed asset register.
- During the final phase of our audit we will substantively test additions and valuations to ensure that these are correctly accounted for in line with the component requirements of IAS 16.

### Consolidations and Associates

#### Expected impact of IAS 27 & 28

- UK GAAP emphasises the **substance** of control eg rather than legal voting rights whereas IFRS considers the **power** to control. As a result there may be a different interpretation of those entities consolidated into group financial statements.

#### Our audit work

- During the interim audit we will consider the Council's evaluation of its relationships with external partners to assess whether they should now be consolidated under the new standards.
- We will audit the consolidated statements during the final phase in line with IAS 27 & 28.

# Key financial statement audit risks (continued)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

## Key audit risks



## Impact on audit plan

### Contingent Liabilities

The contingent liabilities disclosed in the financial statements in 2009/10 could be financially significant if they were to crystallise. Therefore, if the Council does not reflect the latest position in relation to these events the financial statements could be significantly mis-stated.

- We have discussed the latest position of Luneside East with the Head of Financial Services. We will also meet with the Monitoring Officer to keep aware of further developments.
- We will critically review any correspondence received from legal representatives regarding Luneside East and take account of any hearings, rulings or appeals.

### Revenues and Benefits Shared Service

The use of new Shared Service for revenues and benefits with Preston City Council to administer and collect the revenues and benefits applicable to Lancaster from 1 July 2011 will pose particular challenges for the Council. These will include a change to processes in relation to revenues and benefits and ensuring the Council maintains close oversight of the performance and control environment of this Shared Service centre. In addition, the Council will need to ensure that the Shared Service delivers the planned efficiencies in the budget.

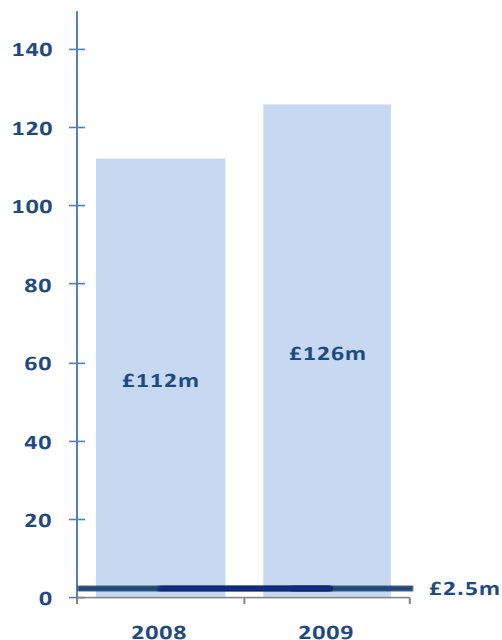
- We have discussed the arrangements for the move to the Shared Service for revenues and benefits processing with the Accountancy Services manager and will update our understanding at the interim visit.
- We will test the controls around revenue and benefits, in liaison with Preston City Council's auditors, to ensure that our audit approach is efficient and to gain assurances that appropriate controls are in place over balances, so that they are not materially mis-stated.

# Materiality

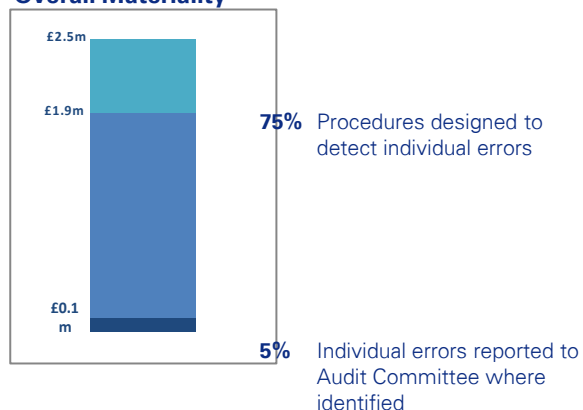
Our audit work is planned to detect errors that are material to the accounts as a whole.

Our materiality of this year is £2.5m

Total revenue



Overall Materiality



## What do we mean by materiality?

In layman terms, materiality is the margin of error we will accept before we qualify our opinion on the accounts.

## Why do we have a level of materiality?

We only have a limited time in which to complete our work. As a result, we focus our testing on a sample of transactions rather than everything. To make our sample testing most effective, our work is driven by an assessment of risk and a level of materiality. This means we sample test the transactions that are more likely to be prone to significant fraud or error.

## Determining materiality

- We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.
- Materiality has been set at £2.5m million which is 2% of total revenues.
- We design our procedures to detect errors at a lower level of precision, i.e. £1.9 million. We have some flexibility to adjust this level downwards.

## Reporting to Audit Committee

- To comply with auditing standards, the following three types of audit differences will be presented to the Audit Committee:
  - summary of adjusted audit differences
  - summary of unadjusted audit differences
  - summary of disclosure differences (adjusted and unadjusted).
- We will not report audit and disclosure differences that are considered to be trivial.

Note: Materiality may be updated on receipt on the draft financial statements

Source: Management accounts / forecast (2010)

# Audit Team

Our audit team has changed from last year. Contact details are shown on page 1

The audit team will be assisted by other specialist KPMG staff as necessary.



Steve Clark  
**Engagement Lead**

My role is to lead our team and ensure the delivery of a high quality external audit opinion. I will be the main point of contact for the Audit Committee and the Chief Executive.



Heather Garrett  
**Audit Manager**

I will direct and help coordinate the audit and will work closely with Steve Clark to ensure we add value. I will be the main contact for the Head of Financial Services.



Karl Ballard  
**Audit Assistant Manager**

I will be your day to day contact and will work closely with Heather Garrett to deliver a coordinated and efficient audit. I will be the main contact for the Accountancy Services Manager.

# Independence confirmation

**Our independence and objectivity responsibilities under the Code are summarised in Appendix 3.**

**We confirm our audit team's independence and objectivity is not impaired.**

## **Independence and objectivity confirmation**

Professional standards require 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 standards also place requirements on auditors in relation to integrity, objectivity and independence.

The ISA defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 *Integrity, Objectivity and Independence* requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

## **Confirmation statement**

We confirm that as of 1 February 2011, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Appointed Auditor and audit team is not impaired.

# Audit fees

The audit fee has not changed from that agreed in the high level audit strategy in April 2010.

We agreed our fee for the audit with the Council earlier this year. The fee is calculated with reference to a number of factors including your turnover and our assessment of audit risk and control environment. This year's fee represents a 5.5% increase over last year (2009/10 = £120,000). This brings the fee in line with the Audit Commission scale fee.

Element of the audit	Fee 2010/11
Audit fee	£135,000
Less: IFRS Reimbursement	(£8,351)
<b>TOTAL AUDIT FEE</b>	<b>£126,649</b>
Certification of claims and returns (estimate)	<b>£36,000</b>

To enable you to benchmark our fee proposal we provide below some comparative information.

Source of fee comparative / benchmark	£
Audit Commission suggested fee range	£96,935 - £180,023
Audit Commission suggested scale fee	£138,479
2010/11 audit fee	£135,000

# Audit fees (continued)

**Our audit fee is indicative and based on you meeting our expectations of your support.**

**Meeting these expectations will help to the delivery of our audit within the proposed audit fee.**

## Audit fee assumptions

The audit fee is indicative and is based on you meeting our agreed expectations as outlined in Appendix 2. In setting the fee, we have assumed:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform us of any significant developments impacting on our audit;
- you will identify and implement any changes required under the CIPFA Code of Practice on Local Authority Accounting within your 2010/11 financial statements (note 2010/11 is the first year based on IFRS);
- your financial statements are made available for audit in line with the agreed timescales;
- you will make available the re-stated 2009/10 figures in line with the agreed timescales and ensure they are in line with IFRS requirements;
- good quality working papers and records will be provided at the start of the final accounts audit;
- requested information will be provided within the agreed timescales;
- prompt responses will be provided to queries and draft reports;
- Internal Audit meets appropriate professional standards;
- Internal Audit completes appropriate work on all systems that provide material figures for the financial statements and we can place reliance on them for our audit; and
- additional work will not be required to address questions or objections raised by local government electors.

Meeting these expectations will help ensure the delivery of our audit within the agreed audit fee.

## Changes to the audit plan

Changes to this plan and the audit fee may be necessary if:

- new significant audit risks emerge;
- additional work is required of us by the Audit Commission or other regulators; and
- additional work is required as a result of changes in legislation, professional standards or financial reporting requirements.

If changes to this plan and the audit fee are required, we will discuss and agree these initially with the Head of Financial Services, as Section 151 Officer.



# Audit timeline & deliverables

Our key deliverables will be delivered to a high standard and on time.

We will discuss and agreed each report with the Council's officers prior to publication.

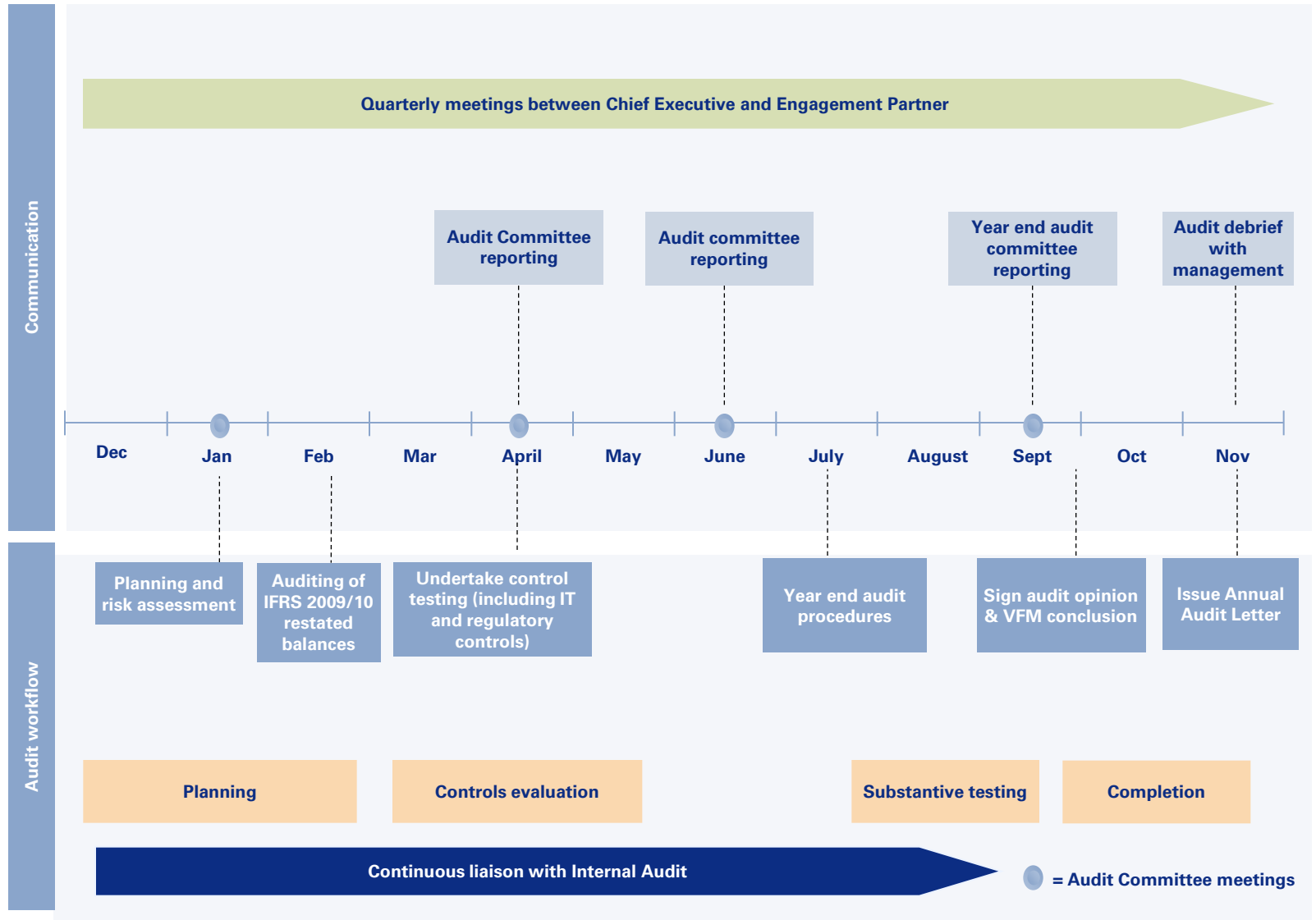
Deliverable	Purpose	Timing
<b>Planning</b>		
<b>Audit plan</b>	<ul style="list-style-type: none"> <li>Outline audit approach</li> <li>Identify areas of audit focus and planned procedures</li> <li>Confirm plan with Audit Committee</li> </ul>	<b>February 2011</b>
<b>Interim</b>		
<b>Interim report</b>	<ul style="list-style-type: none"> <li>Details and resolution of control and process issues</li> </ul>	<b>April 2011</b>
<b>Report on restated 2009/10 figures</b>	<ul style="list-style-type: none"> <li>Feedback on audit work undertaken on 2009/10 restated balances in line with IFRS</li> <li>Identify areas of improvement to ensure 2010/11 financial statements are fully compliant with IFRS</li> </ul>	<b>April 2011</b>
<b>Year end audit</b>		
<b>Report to those charged with governance (ISA 260)</b>	<ul style="list-style-type: none"> <li>Commentary on financial statements</li> <li>Commentary on the Council's value for money arrangements</li> <li>Details the resolution of key audit issues</li> <li>Communication of adjusted and unadjusted audit differences</li> <li>Performance improvement recommendations identified during our audit</li> </ul>	<b>September 2011</b>
<b>Opinion on financial statements</b>	<ul style="list-style-type: none"> <li>Independent auditors' report to the Members of the Council</li> </ul>	<b>September 2011</b>
<b>Annual audit letter</b>	<ul style="list-style-type: none"> <li>Summaries the audit we have performed with key audit issues and outputs</li> </ul>	<b>November 2011</b>

# Audit timeline & deliverables (continued)

Key formal interactions with the Audit Committee are:

- April: Interim issues
- September: Year end conclusions.

We will be in continuous dialogue with you throughout the audit.



# Appendix 1: Meeting your expectations

## How we will conduct ourselves

### *Communications*

- We will be proactive in developing relationships with your staff where our audit work requires their input.
- We will ensure that all letters and emails are answered within five working days of receipt. All telephone messages received will receive a prompt response, either by the individual concerned or Karl Ballard.
- We will ensure that all recommendations, and in particular those relating to our performance management work, are included within our Annual Audit Letter only after having been agreed with relevant Directors.
- Steve Clark or Heather Garrett will attend Audit Committee meetings and ensure that other relevant KPMG staff are invited as appropriate.
- We have been working with you throughout 2009/10 providing guidance on key issues in the transition to IFRS. We will continue working with the Finance Team to provide advice and review progress during 2010/11.

### *Working together*

- We will ensure that the Director of Finance, Chief Accountant and other key members of staff are kept informed of the progress of our audit work throughout the year.
- We will liaise with staff at all levels of the Council to ensure that our work is appropriately planned and completed and where recommendations are made these are agreed with the likely responsible officer.

### *Cooperating with the Council*

- We will continue to coordinate our work with that of Internal Audit and ensure that we provide appropriate proactive commentary to the finance function on issues that affect the Council's accounts.
- We will respond promptly to requests for comment on aspects of the Council's operations, where appropriate.

## Our expectations of your support

### *Audit Plan*

- Brief our staff on key issues affecting the Council.
- Review and agree the draft plan.

### *Interim Audit*

- Facilitate the completion of Internal Audit's work (particularly on core financial systems) to timetable.
- Ensure that key officers are available for the duration of our audit.
- Respond to and agree our draft reports in good time.

### *Accounts Audit*

- Ensure that a full draft of the accounts is available at least one week prior to the agreed start date of our audit, and that only agreed adjustments are put into the accounts following receipt of this draft.
- Produce the documents listed within our prepared by client request by the agreed start date of our audit.
- Ensure that the mandatory content of the Annual Report is available at the agreed time of our final account audit.

### *Annual Audit Letter*

- Discuss and agree our draft Annual Audit Letter in good time for the Audit Committee.
- Ensure that all action plans are agreed and followed up in due course.

### *IFRS*

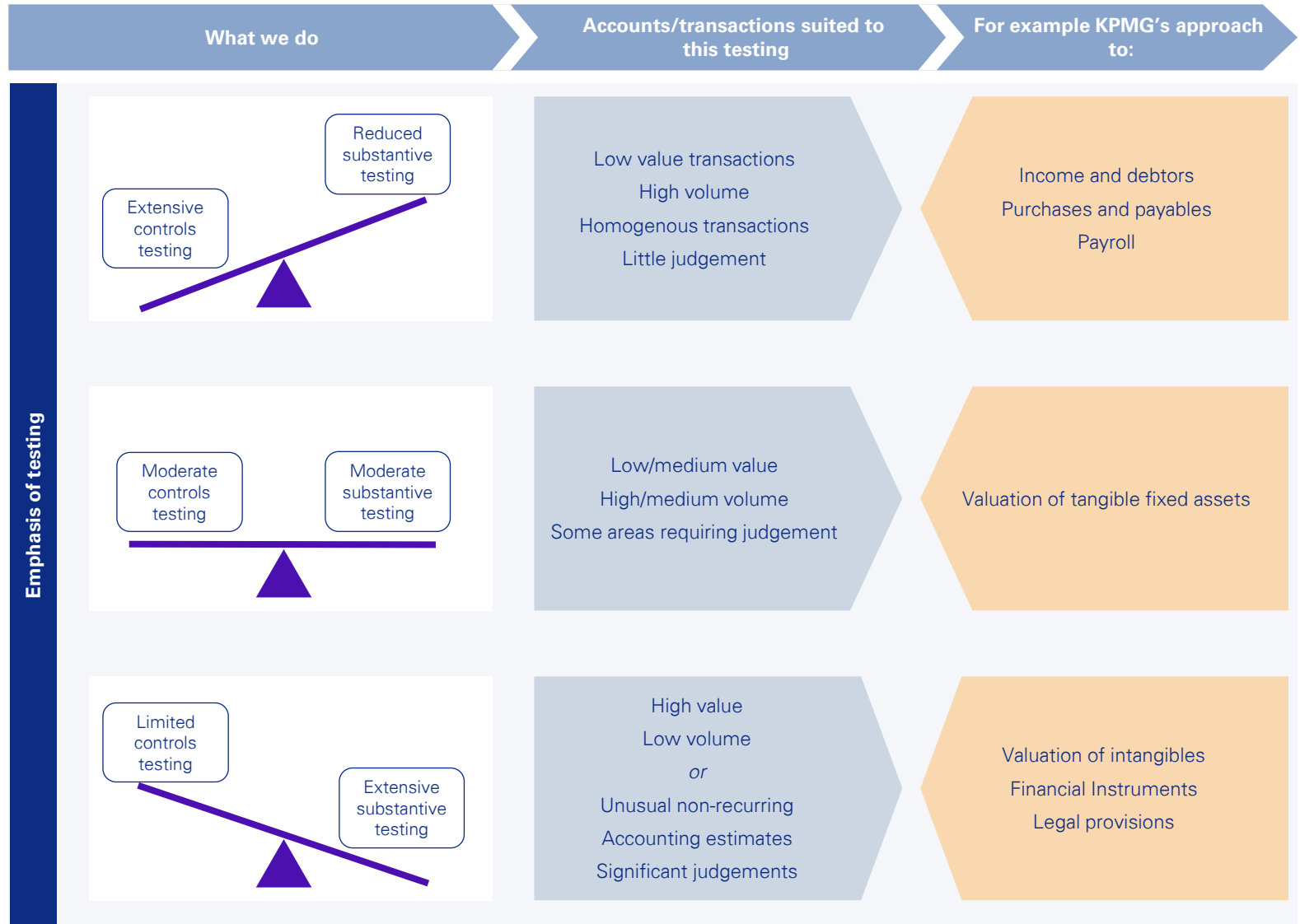
- Ensure a full set of 2009/10 restated figures compliant with IFRS are available to audit in good time prior to the final visit.

### *Other work*

- Agree a key Council contact as a focal point for the study or work.
- Discuss and review our findings so that action plans can be fully completed and implemented.

# Appendix 2: Balance of internal controls and substantive testing

This appendix illustrates how we determine the most effective balance of internal controls and substantive audit testing



Note: Assuming controls are found to operate as designed

# Appendix 3: Independence and objectivity requirements

This appendix summarises auditors' responsibilities regarding independence and objectivity.

## Independence and objectivity

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; and
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Council invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.

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 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 the Engagement Lead to be changed on each audit at least once every five years (subject to agreed transitional arrangements). Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead 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 Engagement Lead 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.

## Appendix 4: Quality assurance and technical capacity

We continually focus on delivering a high quality audit. This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff. Quality must build on the foundations of well trained staff and a robust methodology. The diagram summarises our approach and each level is expanded upon below.

We recruit the best staff through our rigorous selection and assessment criteria. In addition, we expect that future talent to develop with our application of most effective in-house and external training support.

Our audit methodology determines that we use a standardised audit approach and pro forma work papers. We also have standards of audit evidence and working papers including requirements for working paper retention.

At critical periods of the audit we conduct both manager and engagement leader review of the work completed. Upon final completion, managers and directors complete a checklist to indicate the satisfactory conclusion of the audit under the audit methodology.

Partners who meet certain skills and experience criteria, conduct quality control reviews of individual audits depending on the level of audit risk. Their role is to perform an objective evaluation of the significant accounting, auditing and financial reporting matters with a high degree of detachment from the audit team. This provides an objective internal assessment on the quality of our audit. Peer review is undertaken across the firm, with an annual sample of our work being undertaken from a different national office. This encourages a constant focus on quality and ensures there is continuous improvement and that best practice is shared.

### Our quality review results

We are able to evidence the quality of our audits through the results of National Audit Office and Audit Commission reviews. The results of the Audit Commission's annual quality review process is made publicly available each year ([www.audit-commission.gov.uk/reports/](http://www.audit-commission.gov.uk/reports/)). The latest report dated October 2010 showed that we performed highly against all the Commission's criteria.

### Resolving Accounting and Financial Report Issues and Emerging Issues with the Independent Regulator

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director (based in our London office) who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA and the Audit Commission) as well as acting as a sounding board for our auditors.
- A national technical network of public sector audit professionals (that meets on a quarterly basis) and is chaired by our national technical director.
- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's Code of Audit Practice.
- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based bi-monthly technical training.

When dealing with the Audit Commission, as you would expect we both attend and cascade across the firm the papers considered by their various technical groups for auditors. In addition, as the Audit Commission has developed we have established a series of formal and informal relationships. These benefit both the Audit Commission and our Local Authority clients. As a result of all of these factors, and combined with our overall audit approach, we seek to offer early warnings of issues arising with the independent regulator and provide pragmatic solutions.

