

Audit Strategy

Shropshire Council

Audit 2011/12



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Introduction

This plan sets out the work for the 2011/12 audit. The plan is based on the Audit Commission's risk-based approach to audit planning.

Responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

I comply with the statutory requirements governing my audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice for local government bodies.

My audit does not relieve management or the Audit Committee, as those charged with governance, of their responsibilities.

Background

I have previously commented that the Council continues to face challenges around its current and future funding. Finding the required savings has been a big challenge for the Council. Your most recent forecast is that the Council needs to achieve savings of £85m over a four-year period, of which £32.3m was planned for 2011/12. Good progress has been made in meeting this target for 2011/12 however, there remains £1.525m of identified savings which are unlikely to be achieved in the financial year because of the time required for the savings to come to fruition and the creation of risks to service disruption and loss of jobs. The overall impact on the General Fund balance is that it is projected you will only be able to hold the balance at the minimum level you deem prudent for 2011/12 and 2012/13 (£5.8m for 2012/13). However, in 2013/14 your estimated level of reserves has reduced to £11.4m. At the same time, your target level of reserves for 2013/14 has increased to £14.1m. It is important that there is a balance between the need for general reserves against the impact on the budget of achieving them. However, until this is achieved it places the Council at risk of being unable to uphold its financial resilience. Against this background, the Council has responded in a positive manner. You have introduced your New Operating Model aimed at protecting front-line services while achieving the necessary efficiency savings. For the first six months of 2011/12 you have reported that 71 per cent of outcomes measures were within or above 10 per cent of the standards set. However, you have also recognised the challenges faced in a small number of service areas. This is a difficult, but manageable, position and these factors have been taken into account in compiling the 2011/12 Audit Plan.

Accounting statements and Whole of Government Accounts

I will carry out the audit of the accounting statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB). I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view.

Materiality

I will apply the concept of materiality in planning and performing my audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

Identifying audit risks

I need to understand the Authority to identify any risk of material misstatement (whether due to fraud or error) in the accounting statements. I do this by:

- identifying the business risks facing the Authority, including assessing your own risk management arrangements;
- considering the financial performance of the Authority;
- assessing internal control, including reviewing the control environment, the IT control environment and internal audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Authority's information systems.

This plan reports the risks I have identified at the time of reporting. If material risks change or new ones are identified that impact upon my proposed audit plan I will report them separately to the Audit Committee.

Identification of significant risks

I have considered the additional risks that are relevant to the audit of the accounting statements and have set these out below.

Table 1: **Significant risks**

Risk	Audit response
<p>Heritage Assets</p> <p>The 2011/12 Code adopts the requirements of FRS 30 Heritage Assets. The Council has already started to identify any assets captured by this definition. However the valuation of these may be more difficult.</p> <p>A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture. For Shropshire Council this is likely to include your Museum Service and archives.</p>	<p>I will evaluate the management controls you have in place to recognise and value heritage assets. I will also undertake testing to check that the Authority has accounted for heritage assets in accordance with FRS 30 and the Code and the financial statements are fairly stated.</p>
<p>Redundancy</p> <p>The Council's estimated redundancy costs for 2011/12 are forecast to be £8.102m. There is an associated capitalisation order of £3.2m which will reduce the impact of this on the Revenue account. This could lead to a material redundancy provision in the financial statements that will need to be calculated in line with the statutory framework.</p>	<p>I will substantively test the redundancy provision in the financial statements, including a sample of any actual in year redundancy figures, to ensure compliance with statutory regulations.</p>

Identification of specific risks

I have considered the additional risks that are appropriate to the current opinion audit and have set these out below

Table 2: **Specific risks**

Risk	Audit response
<p>Pension Liability</p> <p>International Accounting Standard (IAS) 19 Employee Benefits applies to all Local Authorities. Auditors need assurance on the entries required by IAS 19. Under Regulation 36 of the LGPS Administration Regulations 2008, the pension fund is subject to an independent triennial valuation. Between valuations the assets & liabilities for each employer are estimated using a roll forward approach. It is important that matters of significance affecting the actuarial valuation (e.g. major redundancy programmes) are reported to the Actuary.</p>	<p>I will review the arrangements to ensure that information provided to the Actuary in relation to redundancies accurately reflects the position at Shropshire Council.</p>
<p>Accounting for Schools</p> <p>Under the Education Act 1996, local authorities are responsible for securing sufficient schools within their area. The different types of school are:</p> <ul style="list-style-type: none"> ■ Community Schools; ■ Voluntary control / aided; ■ Foundation; and ■ Academies <p>The differences in those arrangements have implications for the accounting treatment within the financial statements.</p>	<p>I will review the arrangements in place to review the status of the various types of schools and ensure they are accounted for correctly within the financial statements.</p>
<p>HRA self financing</p> <p>As part of the Localism Bill 2010, local authority housing finance will be</p>	<p>I will review the accounting arrangements to ensure that the Council has recognised the payment to central government as specified in the</p>

replaced by a self-financing model from 1 April 2012. This replaces the Housing Revenue Account Subsidy (HRAS) system operated under section 80 of the Local Government and Housing Act (LGHA) 1989. This will be implemented through a one-off settlement payment to or from the government, to adjust the housing debt of local housing authorities and leave each with a level of HRA debt considered affordable from rental income.

settlement payment determination and has accounted for the transaction in line with proper practices. This includes, where appropriate, separate disclosure of the transaction as an exceptional item.

PFI schemes

The Council has two PFI schemes which are subject to complex accounting arrangements.

I have undertaken audit work in the past to provide me with assurance over the models and assumptions used to support disclosures in your financial statements. I will examine the inputs to the PFI models to ensure figures are truly and fairly stated in the financial statements.

Deferred Liabilities

My 2010/11 audit identified an uncertainty within the accounting of the deferred liabilities balance of £20.830m. This is shown within long term liabilities but includes sums due within 12 months of the balance sheet date which would normally be disclosed within current liabilities.

I will revisit this in 2011/12 to identify if information is now available to ensure that the value for deferred liabilities is properly disclosed within the financial statements.

Group Financial Statements

There are potential changes to the group components in 2011/12 in the form of a disposal of a component. Due to the uncertainty of the timing of the event, there is a possibility that the disposal will need to be properly reflected in the group financial statements.

I will undertake a review of the group financial statements to ensure that they properly reflect the position of the group at the balance sheet date.

Testing strategy

My audit involves:

- review and re-performance of work of your internal auditors;
- testing of the operation of controls;
- reliance on the work of other auditors;
- reliance on the work of experts; and
- substantive tests of detail of transactions and amounts.

I have sought to:

- maximise reliance, subject to review and re-performance, on the work of your internal auditors; and
- maximise the work that can be undertaken before you prepare your accounting statements.

The nature and timing of my proposed work is as follows.

Table 3: **Proposed work**

	Review of internal audit	Controls testing	Reliance on the work of other auditors	Reliance on work of experts	Substantive testing
Interim visit	General Ledger Payroll Carefirst	All other controls rolled forward.	N/A	N/A	
Final visit		General ledger year end controls Other year end processes and reconciliations.	Pensions assets and liabilities – verification supplied from our review as auditor to Shropshire County Pension Fund.	Pensions liabilities and assets – verification from the Actuary. Valuation of property, plant and equipment (PPE) – reliance placed on the Council's in house valuer. I will also utilise the Audit Commission's own expert (Gerald Eve) in informing	All material accounts balances and amounts Year-end feeder system reconciliations

**Review of
internal audit**

**Controls
testing**

**Reliance on the work of other
auditors**

**Reliance on work of
experts**

Substantive testing

me of the reasonableness
of the Council's PPE
valuation.

I will agree with you a schedule of working papers required to support the entries in the accounting statements.

Whole of Government Accounts

Alongside my work on the accounting statements, I will also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report are specified by the National Audit Office. I have considered the additional risks that are appropriate to the current audit and have set these out below.

Table 4: **Specific risks**

Risk	Audit response
<p>Whole of Government Accounts (WGA)</p> <p>Infrastructure assets are measured in the accounts at historical costs. All other classes of assets, except assets under construction, are held at fair value or, where no market based evidence is available, depreciated replacement cost (DRC). HM Treasury have expressed concern that the valuation of local government infrastructure assets is inconsistent with the measurement of similar assets in WGA. To address this, 2011/12 will see a dry run using full DRC balances, including valuations in the WGA return.</p>	<p>I will test the existence of highways infrastructure assets, which will involve testing of the Council's systems for identifying and recording such assets. I will consider whether the measurement and presentation of transport infrastructure assets at historic cost in the financial statements is materially correct. I will review the arrangements in place to meet the requirements for reporting on transport infrastructure assets on a DRC basis for WGA purposes.</p>

Value for money

I am required to reach a conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness.

My conclusion on the Authority's arrangements is based on two criteria, specified by the Commission. These relate to the Authority's arrangements for:

- securing financial resilience – focusing on whether the Authority is managing its financial risks to secure a stable financial position for the foreseeable future; and
- challenging how the Council secures economy, efficiency and effectiveness – focusing on whether the Authority is prioritising its resources within tighter budgets and improving productivity and efficiency.

Identification of significant risks

I have considered the risks that are relevant to my value for money conclusion. I have identified the following significant risks that I will address through my work.

Table 5: **Significant risks**

Risk	Audit response	Separate audit output?
Securing financial resilience – financial planning and control. The Council has faced significant financial pressures which have seen the general fund balance fall below its specified minimum levels required to safeguard it against	Ongoing monitoring of the financial position to ensure that the Council can maintain its financial resilience, including a focus on the level of reserves. This will be undertaken through review of the Cabinet minutes, discussions with officers and review of the Medium Term Financial Plan (MTFP).	No as it will be reported upon in the Annual Governance Report.

Risk	Audit response	Separate audit output?
<p>future unexpected spending pressures.</p> <p>Securing economy, efficiency and effectiveness – improving efficiency and productivity. The Council’s MTFP includes plans to save £2 million through sharing service delivery. This will create uncertainty for staff and service users. There is a risk that the process of transformation will impact on the delivery of services.</p>	<p>I will consider how the Council is progressing in the development of its approach to shared services. I will consider the outputs from the Council’s working group which is overseeing the development of the approach to shared services.</p>	<p>No as it will be reported upon in the Annual Governance Report.</p>

Key milestones and deadlines

The Authority is required to prepare the accounting statements by 30 June 2012. I aim to complete my work and issue my opinion and value for money conclusion by 30 September 2012.

Table 6: **Proposed timetable and planned outputs**

Activity	Date	Output
Opinion: controls and early substantive testing	December 2011-March 2012	Annual Governance Report
Opinion: receipt of accounts and supporting working papers	9 July 2012	N/A
Opinion: substantive testing	July - August 2012	N/A
Value for money: other work	March – August 2012	Annual Governance Report
Present Annual Governance Report at the Audit Committee	September 2012	Annual Governance Report
Issue opinion and value for money conclusion	By 30 September 2012	Auditor's report
Summarise overall messages from the audit	October 2012	Annual Audit Letter

The audit team

The key members of the audit team for the 2011/12 audit are as follows.

Table 7: **Audit team**

Name	Contact details	Responsibilities
Grant Patterson District Auditor	g-patterson@audit-commission.gov.uk 0844 798 7816	Responsible for the overall delivery of the audit including quality of reports, signing the auditor's report and liaison with the Chief Executive.
Erik Bagnall Audit Manager	e-bagnall@audit-commission.gov.uk 01743 252941	Manages and coordinates the different elements of the audit work. Key point of contact for the Director of Finance.
Bethan Vaghela Team Leader	b-vaghela@audit-commission.gov.uk 01743 252941	Co-ordinates different elements of audit work. Day to day contact for Finance staff.

Independence and quality

Independence

I comply with the ethical standards issued by the APB and with the Commission's additional requirements for independence and objectivity as summarised in appendix 1.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

Quality of service

I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director – Standards & Technical, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and to do what he can to resolve the position.

If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

Fees

The fee for the audit is £295,650, as set out in my letter of 15 April 2011.

The audit fee

The Audit Commission has set a scale audit fee of £295,650 which represents a 10 per cent reduction on the audit fee for 2010/11.

The scale fee covers:

- my audit of your accounting statements and reporting on the Whole of Government Accounts return; and
- my work on reviewing your arrangements for securing economy, efficiency and effectiveness in your use of resources.

The scale fee reflects:

- the Audit Commission's decision not to increase fees in line with inflation;
- a reduction resulting from the new approach to local VFM audit work; and
- a reduction following the one-off work associated with the first-time adoption of International Financing Reporting Standards (IFRS).

Variations from the scale fee only occur where my assessments of audit risk and complexity are significantly different from those reflected in the 2010/11 fee. I have not identified significant differences and have therefore set the fee equal to the scale fee.

Assumptions

In setting the fee, I have made the assumptions set out in appendix 2. Where these assumptions are not met, I may be required to undertake more work and therefore increase the audit fee. Where this is the case, I will discuss this first with Head of Finance and Commerce and I will issue a supplement to the plan to record any revisions to the risk and the impact on the fee.

Specific actions you could take to reduce your audit fee

The Audit Commission requires me to inform you of specific actions you could take to reduce your audit fee. I will work with your finance team to identify any specific actions that the Council could take and to provide ongoing audit support.

Total fees payable

In addition to the fee for the audit, the Audit Commission will charges fees for:

- certification of claims and returns; and
- the agreed provision of non-audit services under the Audit Commission's advice and assistance powers.

Based on current plans the fees payable are as follows.

Table 8: Fees

	2011/12 proposed £	2010/11 actual £	Variance £
Audit	295,650	328,500	(32,850)
Certification of claims and returns	66,000	66,805	(805)
Total	361,650	395,305	(33,655)

Appendix 1 – Independence and objectivity

Auditors appointed by the Audit Commission must comply with the Commission’s Code of Audit Practice and Standing Guidance for Auditors. When auditing the accounting statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB). These impose stringent rules to ensure the independence and objectivity of auditors. The Audit Practice puts in place robust arrangements to ensure compliance with these requirements, overseen by the Audit Practice’s Director – Standards and Technical, who serves as the Audit Practice’s Ethics Partner.

Table 9: **Independence and objectivity**

Area	Requirement	How we comply
Business, employment and personal relationships	<p>Appointed auditors and their staff should avoid any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.</p> <p>The appointed auditor and senior members of the audit team must not take part in political activity for a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.</p>	All audit staff are required to declare all potential threats to independence. Details of declarations are made available to appointed auditors. Where appropriate, staff are excluded from engagements or safeguards put in place to reduce the threat to independence to an acceptably low level.

Area	Requirement	How we comply
Long association with audit clients	The appointed auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional consideration of threats to independence after five years.	The Audit Practice maintains and monitors a central database of assignment of auditors and senior audit staff to ensure this requirement is met.
Gifts and hospitality	The appointed auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.	All audit staff are required to declare any gifts or hospitality irrespective of whether or not they are accepted. Gifts and Hospitality may only be accepted with line manager approval.
Non-audit work	<p>Appointed auditors should not perform additional work for an audited body (that is work above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might result in a reasonable perception that their independence could be compromised.</p> <p>Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.</p> <p>Work over a specified value must only be undertaken with the prior approval of the Audit Commission's Director of Audit Policy and Regulation.</p>	All proposed additional work is subject to review and approval by the appointed auditor and the Director – Standards and Technical, to ensure that independence is not compromised.

Code of Audit Practice, Audit Commission Standing Guidance and APB Ethical Standards

Appendix 2 – Basis for fee

In setting the fee, I have assumed the following.

- The risk in relation to the audit of the accounting statements is not significantly different to that identified for 2010/11. For example:
 - internal controls are operating effectively;
 - I secure the co-operation of other auditors; and
- The risk in relation to my value for money responsibilities is not significantly different to that identified for 2010/11.
- Internal Audit meets professional standards.
- Internal Audit undertakes sufficient appropriate work on all systems that provide material figures in the accounting on which I can rely.
- The Authority provides:
 - good quality working papers and records to support the accounting statements and the text of the other information to be published with the statements by 9 July 2012;
 - other information requested within agreed timescales; and
 - prompt responses to draft reports.
- There are no questions asked or objections made by local government electors.

Where these assumptions are not met, I will have to undertake more work which is likely to result in an increased audit fee.

Appendix 3 – Glossary

Accounting statements

The annual statement of accounts that the Authority is required to prepare, which report the financial performance and financial position of the Authority in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

Annual Audit Letter

Report issued by the auditor to the Authority after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

Annual Governance Report

The auditor's report on matters arising from the audit of the accounting statements presented to those charged with governance before the auditor issues their opinion [and conclusion].

Annual Governance Statement

The annual report on the Authority's systems of internal control that supports the achievement of the Authority's policies aims and objectives.

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

Audited body

A body to which the Audit Commission is responsible for appointing the external auditor.

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

Auditing standards

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

Auditor(s)

Auditors appointed by the Audit Commission.

Code (the)

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

Commission (the)

The Audit Commission for Local Authorities and the National Health Service in England.

Ethical Standards

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

Group accounts

Consolidated accounting statements of an Authority and its subsidiaries, associates and jointly controlled entities.

Internal control

The whole system of controls, financial and otherwise, that the Authority establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the accounting statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the accounting statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

The term ‘materiality’ applies only to the accounting statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the accounting statements, which do not necessarily affect their opinion on the accounting statements.

Significance

The concept of ‘significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the accounting statements. Significance has both qualitative and quantitative aspects.

Those charged with governance

Those entrusted with the supervision, control and direction of the Authority. This term includes the members of the Authority and its Audit Committee.

Whole of Government Accounts

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Authority must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its accounting statements.

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0844 798 7070

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The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

