

Audit Opinion Plan

London Borough of Lewisham

Audit 2010/11

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The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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Introduction

This plan sets out the audit work that I propose to undertake for the audit of financial statements and the value for money conclusion 2010/11.

- 1 The plan is based on the Audit Commission's risk-based approach to audit planning. It reflects:
 - audit work specified by the Audit Commission for 2010/11;
 - current national risks relevant to your local circumstances; and
 - your local risks.
- 2 The audit planning process for 2010/11, including the risk assessment will continue as the year progresses and I will keep the information and fees in this plan under review and update it as necessary

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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 every audited body.

3 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 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.

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

- the Audit Commission Act 1998; and
- the Code of Audit Practice.

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Fee for the audit

The fee for the audit is £472,360, as indicated in my letter in April 2010.

5 In my April 2010 letter I proposed an audit fee of £472,360 based on my initial assessment of audit risks. The Audit Commission scale fee for the Council is £459,960. The Commission sets scale fees using several characteristics, including the type, size and location of the audited body as set out in the [2010/11 fee scales](#) document. The fee proposed for 2010/11 is three per cent above the scale fee and is within the normal level of variation specified by the Commission. This takes into account the size, nature and complexity of the Council and our risk assessment.

6 In recognition of the extra work and hence increased audit fee required by International Financial Reporting Standards the Audit Commission agreed to bear that cost in-house and rebated £27,049 in April 2010.

7 The impact of stopping Comprehensive Area Assessment (CAA), including the cost of making several hundred staff redundant, has limited the rebate the Commission can afford to give bodies. However the Commission has rebated 3.5 per cent of the 2010/11 for single-tier and county councils. The Council thus received a £16,099 rebate in January 2011 (3.5 per cent of the scale fee). The Commission will also not charge inspection fees for work already carried out in this financial year on the managing performance part of the organisational effectiveness assessment. This is because there was no value to the work once CAA ended. The fee for the Council is set out below:

Table 1: **Audit Fee at LB Lewisham 2010/11**

Audit Area	Fee letter 28 April 2010	IFRS rebate	VFM rebate	Total fee 2010/11	Total fee 2009/10
Financial statements	£358,568	£27,049		£331,519	£348,900
Value for money conclusion	£113,792		£16,099	£97,693	£113,456
Total opinion fee	£472,360	£27,049	£16,099	£429,212	£462,356

Source: Audit fee letter and fee scales

8 In setting the fee, I have assumed that:

- the level of risk in relation to the audit of accounts is consistent with that for 2009/10;
- good quality, accurate working papers are available at the start of the financial statements audit.

- The Council will supply good quality working papers to support the restatement of 2009/10 balances to comply with International Financial Reporting Standards (IFRS); and
- Internal Audit undertakes appropriate work on all material systems and this is available for our review by 30 April 2011.

9 Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee. Where this is the case, I will discuss this first with the Executive Director of Resources and I will issue supplements to the plan to record any revisions to the risk and the impact on the fee.

Specific actions Lewisham Council could take to reduce its audit fees

10 The Audit Commission requires its auditors to inform audited bodies of specific actions it could take to reduce its audit fees. I will work with staff to identify any specific actions that the Council could take and to provide ongoing audit support. Experience from the 2009/10 audit showed that there was scope for the Council to improve the quality of financial reporting, and the timeliness of working papers and response to audit queries.

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Auditors report on the financial statements

I will carry out the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).

11 I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view of the financial position of the Council as at 31 March 2011.

12 This year's audit will be the first under changed auditing standards known as the 'clarity' standards. I have summarised the differences you will see in Appendix 1. The Audit Commission has committed to absorbing extra costs arising from increased audit procedures.

Materiality

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

14 The new audit standards introduce 'performance materiality'. This does not affect how I report to you, but will affect how I conduct my audit. The change is likely to increase testing as it lowers the numerical threshold for my testing of in the financial statements. My team will discuss in detail with the Council's finance department our testing approach to ensure it remains efficient and proportionate.

Identifying opinion audit risks

15 I need to understand fully the audited body to identify any risk of material misstatement (whether due to fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Council, including assessing your own risk management arrangements;
- considering the financial performance of the Council;
- 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 Council information systems.

Value for money conclusion

16 I am required to give a statutory VFM conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

17 I base this on two criteria, specified by the Commission, related to your arrangements for:

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

18 I will plan a programme of VFM audit work based on my risk assessment. I will no longer provide an annual scored judgement of my local value for money audit work. Instead I will report the results of all my local audit work and the key messages for the Council in my annual governance report and annual audit letter.

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Identification of specific risks

I have considered the additional risks that are appropriate to the current opinion audit and the Value For Money conclusion and have set these out below.

Table 2: **Specific and significant risks identified**

Risk area	Audit response
International Financial Reporting Standards	
<p>Local Authorities must prepare their financial statements under International Financial Reporting Standards from 2010/11 onwards. While this presents many presentational changes there will also be issues of classification or recognition for several significant areas, including leases, PFI schemes, Government grants deferred and accruals.</p>	<p>In line with the Council's timetable I planned for an early review of the Council's restated balances and continuing discussion with Council officers on key accounting judgements. Unfortunately the Council has only provided limited IFRS information to date.</p> <p>There is a risk that if significant issues emerge during the audit, the Council will only have limited time available to address any issues. This may result in additional audit time being needed to audit any outstanding issues during my final accounts audit. Later emerging issues may affect the timeliness and nature of my audit opinion on the accounts.</p>
Managing finances and the Value For Money conclusion	
<p>The current economic climate is having a significant impact on public finances with public bodies expected to deliver major efficiencies. It is likely that there will be reductions in staffing levels.</p> <p>The Council will need to keep financial performance under scrutiny and take necessary action to correct adverse trends.</p>	<p>Continuing review of the Council's spending plans and its reactions to changes in financial circumstances.</p>

Risk area	Audit response
Large scale voluntary transfers	
<p>In the 2009/10 accounts impairments arising from large scale voluntary transfers (LSVTs) were presented incorrectly as losses on disposal. There were also problems in previous years relating to the accounting treatment. Three transfers (Chrysalis) have taken place in 2010/11.</p>	<p>My team will review the accounting treatment relating to new LSVTs in 2010/11. We will also ensure any disclosures relating to LSVTs are in accordance with the Code of Practice.</p>
New financial systems	
<p>The Council has introduced new financial systems during 2010/11.</p> <ul style="list-style-type: none"> - Asset register - NNDR (business rates) system. 	<p>My team will review the new systems to obtain sufficient assurance that information from the old system has been transferred into to ensure no material error exists. I will also document the systems, walk through and test the key controls as appropriate.</p>
Lewisham Homes Limited pension indemnity	
<p>Differing interpretations of the Council's letter of indemnity in respect of pension costs has led to an inconsistency in the Council's group accounts.</p>	<p>We are in discussion with the Council to ensure the differing interpretations of the indemnity are clarified. In particular whether the post transfer costs should be treated as a provision or contingent liability in the Council's accounts.</p>
Cash Flow Statement	
<p>The cash flow is one of the primary statements, which the Council has had problems with in past years producing an accurate and timely version supported by working papers.</p>	<p>On receipt of the financial statements my team will prioritise the cash flow statement for early attention in order to identify any problems at an early stage.</p>
Whole of Government Accounts	
<p>In previous years the Council has not been able to produce timely and accurate Whole of Government Accounts in order to achieve the deadline.</p>	<p>My team will liaise with the Council to take steps to improve WGA procedures.</p>

Testing strategy

On the basis of risks identified above I will produce a testing strategy which will consist of testing key controls and/or substantive tests of transaction streams and material account balances at year end.

19 My main objective as your appointed auditor is to plan and carry out an efficient opinion audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code).

20 I recognise that to achieve these objectives, we need to work together effectively. We need good communication throughout the year to identify and resolve issues early and are flexible enough to manage developments as they arise.

21 To support effective joint working I want you understand my approach to delivering your audit. Table 3 shows a summary of my approach and my timetable.

Table 3: **Summary of my audit approach**

I adopt a two-stage approach

Stage	Procedures	Timing
1. Pre-statements	Documenting and walking through your material information systems. Where applicable, testing of key controls within these systems, including where possible, reviewing the work of internal audit. Evaluating your control environment including assessing general information technology (IT) controls. Where applicable, carrying out testing before the year-end on balances that you expect to be included in the financial statements.	From February to June.
2. Post-statements	Testing the material balances and notes within your financial statements.	From July to September

22 My team will work closely with you throughout the opinion audit.

Pre-statements audit

Documenting and walking through your systems

23 I use the pre-statements stage of the audit to gain an understanding of the information systems that you use to produce the material figures within the financial statements. I am required to do this by auditing standards - ISAs (International Standards on Auditing in the UK and Ireland). However, this understanding enables me to focus my audit on relevant matters. It also enables me to highlight to you any significant weaknesses in how these systems produce materially accurate figures for the financial statements.

24 To achieve this I document my understanding of your material information systems and undertake a 'walk through test'. The walk through test entails tracing a single transaction through the system, from initiation to completion. I am required by auditing standards to do this each year. However, where I have gained an understanding of a system in one year and you have confirmed that there have been no changes to that system I simply walk through the system to confirm my understanding.

Identifying and testing key controls

25 Having documented my understanding of your material information systems I then consider the controls within each system that are key to ensuring the outputs are materially accurate. I call these key controls.

26 Where appropriate I will test that these key controls are operating effectively which provides me with assurance that there is a reduced risk that your financial statements are free from material error. It also enables me to report to you any deficiencies in your system of internal control.

27 Wherever possible, I will seek to rely on the work of Internal Audit to help meet my responsibilities and we have agreed a protocol to achieve this. My team meets regularly with internal audit to discuss the scope and timing of our respective audit plans. If I do seek to place reliance on internal audit I will review and evaluate their work.

Control environment and Information Technology (IT) controls

28 I consider the strength of your control environment and general IT controls in assessing the risk that your financial statements are free from material misstatement.

29 As part of the pre-statements audit, I consider and document the control environment in which you operate. For example, I will discuss with management and the Audit Panel (as those charged with governance) the arrangements that the Council has in place for issues including fraud, governance and complying with laws and regulations.

30 In addition, I also evaluate and test your general IT controls, such as access controls within your material information systems.

Early testing of material balances and notes

31 I am aware that the post-statements stage of my audit falls during a busy period for your finance team. Therefore, I know that you are keen that I reduce, as far as possible, the extent of audit work I need to carry out on your financial statements at that time.

32 During the pre-statements audit, I will agree with your finance team, any aspects of your financial statements that will be known before the year end.

Post-statements audit

33 At the post statements stage of the audit I focus my work on testing of the material balances and notes within your financial statements. The extent of this testing is determined in part by the results of the pre-statements testing.

34 My assessment will also take into account a number of factors including the materiality of the item, political sensitivity, known problems from previous years, any findings from Internal Audit and any changes in accounting practice and CIPFA Code. As a result the work undertaken and the requests for information may differ year on year.

35 I also plan to rely on the work of experts in assessing the Council's valuation of its non-current assets (Principal Valuer) and pension liabilities (Hymans Robertson). Additionally I will place reliance on KPMG, the external auditor, for Lewisham Homes Limited.

36 The 2009/10 audit did not go as smoothly as I would have hoped, although the 2009/10 financial statements were complete they were not adequately supported by working papers on a timely basis. I also noted that the Council did not fully utilise the working paper checklist supplied by my audit team. Using the checklist helps working paper files to be compiled whilst preparing the draft financial statements and ensures all key areas are covered.

37 The weaknesses in supporting information and audit trails meant that my audit team had to raise a large number of audit queries last year. Although I believe officers responded to queries as quickly as possible, this led to significant slippage in the 2009/10 audit programme. I will continue to liaise with the Council.

Whole of government accounts

38 As in previous years, the government requires the Council completes a return to inform the [whole of government accounts \(WGA\) initiative](#) and that I certify the Council's return. I will liaise with Council officers to ensure that I am able to complete my testing of the return efficiently and in line with government requirements. The council needs to take steps to improve WGA procedures as in previous years the Council has not been able to produce timely and accurate WGA in order to achieve the deadline.

Engagement with the Audit Panel

39 International Audit Standards require me to discuss with the Audit Panel certain matters on how it exercises oversight of internal control at the Council. These discussions must include specifically:

- Whether the Panel is aware of any frauds (or potential areas of weakness to fraud) that may result in material misstatement;
- How the Panel gains assurance on compliance with relevant laws and regulations; and
- How the Panel has satisfied itself on the appropriateness of preparing accounts on a going concern basis.

40 I have written separately to the Chair of the Audit Panel on these matters.

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Key milestones and deadlines

The Council is required to prepare the financial statements by 30 June 2011. I am required to complete the audit and issue the opinion and value for money conclusion by 30 September 2011.

41 The key stages in producing and auditing the financial statements are in Table 4.

42 I have agreed with officers a schedule of working papers required to support the entries in the financial statements. The agreed fee is dependent on the timely receipt of accurate working papers.

43 Every week, during the audit, the audit team will meet with the key contact and review the status of all queries. I can arrange meetings at a different frequency depending on the need and the number of issues arising.

Table 4: **Proposed timetable**

Activity	Date
Control and early substantive testing	February to June 2011
Receipt of accounts	By 30 June 2011
Sending audit working papers to the auditor	By 30 June 2011
Start of detailed testing	July 2011
Progress meetings	Monthly during the year but weekly throughout the post statements audit
Present report to those charged with governance at the Audit Panel	21 September 2011
Issue opinion and value for money conclusion	By 30 September 2011

The audit team

Table 5 shows the key members of the audit team for the 2010/11 audit.

Table 5: **Audit team**

Name	Contact details	Responsibilities
Sue Exton District Auditor	s-exton@audit-commission.gov.uk 0844 798 2307	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Chief Executive.
Geoffrey Banister Audit Manager	g-banister@audit-commission.gov.uk 0844 798 2434 0781 587 8145	Manages and coordinates the different elements of the audit work. Key point of contact for the Executive Director of Resources.
Jayne Rhodes Audit Manager	j-rhodes@audit-commission.gov.uk 0844 798 2673	Responsible for day-to-day direction of the audit work. Key point of contact for the chief accountant.

Independence and objectivity

44 I am not aware of any relationships that may affect the independence and objectivity of the District Auditor and the audit staff, which I am required by auditing and ethical standards to communicate to you.

45 I comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised in Appendix 2.

Meetings

46 The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers. Our proposals are set out in Appendix 3.

Quality of service

47 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 of Professional Practice, 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.

48 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).

Planned outputs

49 My team will discuss and agree reports with the right officers before issuing them to the Audit Panel.

Table 6: **Planned outputs**

Planned output	Indicative date
Audit Opinion Plan	May 2011
Annual Governance Report	September 2011
Auditor's report giving an opinion on the financial statements	September 2011
Annual Audit Letter	November 2011

Appendix 1 2010/11 opinion audit: changes you can expect to see

In delivering the audit of your financial statements I must comply with the International Standards on Auditing (ISAs). These standards prescribe the basic principles and essential procedures, with the related guidance, which govern my professional conduct as your auditor.

As with all guidance and frameworks, the auditing profession often revises and updates auditing standards, often in a piecemeal fashion. However, in 2009 the auditing profession completed a comprehensive project to improve the clarity of all the ISAs. The audit profession refer to this as the Clarity Project.

One of the main objectives of the Clarity Project was to promote greater consistency of application between auditors. The Project achieved this by reducing the ambiguity within existing ISAs and improving their overall readability and understandability.

The [new clarified standards](#) will apply to my audit of your 2010/11 financial statements. Because of the new standards, you can expect to see some changes in the way my audit team delivers your audit and the information they seek. The purpose of this document is to highlight to you the main changes and how they will impact you.

In summary the main changes you will see concern:

- Journals;
- Related Party Transactions;
- Accounting Estimates;
- Reporting deficiencies in internal control.

Journals

ISA (UK&I) 330 (The Auditor's response to assessed risks), requires me to review all material year-end adjustment journals. I can do this by using interrogation tools such as CAATs (Computer aided audit techniques), IDEA software or excel, depending on the compatibility of your general ledger software. My Audit Manager will discuss a suitable approach to this work with officers.

Related Party Transactions

ISA (UK&I) 550 (Related parties) requires me to review your procedures for identifying related party transactions and gain an understanding of the controls that you have set up to identify such transactions. I will also review minutes and correspondence for evidence of related party transactions and carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Accounting Estimates

ISA (UK&I) 540 (Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures) requires me to look at your accounting estimates in detail. As part of my audit I will ask for a list of these from you. I will need to know in particular:

- the method you use to make your accounting estimates;
- the controls you use to identify them;
- whether you use an expert to help you in making the accounting estimates;
- whether you discussed any alternative estimates and why you rejected them;
- how you assess the degree of estimation doubt (this is the doubt arising because the estimate cannot be precise or exact); and
- the prior year's accounting estimates outcomes, and whether there has been a change in the method of calculation for the current year.

Deficiencies in internal control

ISA (UK&I) 265 (Communicating Deficiencies In Internal Control To Those Charged With Governance And Management) is a new standard.

If I identify a deficiency in any of your internal controls during the audit, I will undertake extra audit testing to decide whether the deficiency is significant. If I decide the deficiency is significant, I will report it in writing to the Audit Panel.

Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee that the auditor has charged the client; and
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Panel.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into 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.

The Standing Guidance for Auditors includes a number of specific rules. The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit and Inspection Plan as

being 'additional work' and charged for separately from the normal audit fee.

- 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.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional safeguards in the last 2 years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of 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.

The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

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Appendix 3 Working together

Meetings

The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers.

My proposal for the meetings is as follows.

Table 7: **Proposed meetings with officers**

Council officers	Audit Commission staff	Timing	Purpose
Executive Director of Resources	District Auditor, Audit Manager	Quarterly	General update plus: <ul style="list-style-type: none"> ■ April – audit plan; ■ July/August – accounts progress; and ■ September – annual governance report ■ November - annual audit letter
Accounts team	Audit Manager and Team Leader	Monthly during the year but weekly throughout the post statements audit	Update on audit issues
Audit Panel	District Auditor, Audit Manager	As determined by the Panel	Formal reporting of: <ul style="list-style-type: none"> Audit Plan Annual governance report Annual audit letter Other issues as appropriate

Sustainability

The Audit Commission is committed to promoting sustainability in our working practices and I will actively consider opportunities to reduce our impact on the environment. This will include:

- reducing paper flow by encouraging you to submit documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.