

Watford Borough Council

Accounts Audit Approach Memorandum

March 2012

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Our accounts audit approach

This memorandum is intended to provide additional detail regarding our audit approach, as set out in our 2011/12 Audit Plan issued in January 2012, as well as an update on our response to key risks from the results of interim audit work carried out to date.

Audit approach reminder

We will:

- work closely with the finance team to ensure that we meet audit deadlines and conduct the audit efficiently
- plan our audit on an individual task basis at the start of the audit, and agree timetables with all staff involved; and
- consider the materiality of transactions when planning our audit and when reporting our findings

The logistical details of our annual accounts audit, as agreed with the Head of Strategic Finance, are detailed in Appendix A to this memorandum.

Planning	<ul style="list-style-type: none">• Updating our understanding of the Council through discussions with management and a review of in year internal financial reporting• Identifying and resolving specific accounting treatment issues
Control evaluation	<ul style="list-style-type: none">• Reviewing the design effectiveness and implementation of internal financial controls including IT, where they impact the financial statements• Assessing audit risk and developing and implementing an appropriate audit strategy• Testing the operating effectiveness of selected controls• Assessing the Council's arrangements for complying with tax legislation and Bribery Act requirements• Assessing the effectiveness of internal audit
Substantive procedures	<ul style="list-style-type: none">• Reviewing material disclosure issues in the financial statements• Performing analytical review• Verifying all material income and expenditure and balance sheet accounts, taking into consideration whether audit evidence is sufficient and appropriate
Completion	<ul style="list-style-type: none">• Performing overall evaluation of our work on the financial statements to determine whether they give a true and fair view• Determining an audit opinion• Reporting to Finance, Audit and Risk Committee through our ISA 260 report and Annual Audit Letter

Materiality

An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true or fair view.

Materiality is set at the outset of planning to ensure that an appropriate level of audit work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences greater than 2% of materiality will be recorded on a schedule of potential misstatements.

These are assessed individually and in aggregate, communicated to you and, if you agree with any management decisions to not adjust for such items, signed off by you in your letter of representation to us, confirming your view that they are immaterial to the financial statements.

An item of low value may be separately judged to be material by its nature, for example any item that affects the disclosure of directors' emoluments. An item of higher value may equally be judged not material if it does not distort the truth and fairness of the financial statements.

Reliance on internal audit

We work with the internal audit function to ensure our audit approach takes account of the risks identified from reviews they have conducted relevant to the financial statements, subject to our review of the effectiveness of the internal audit function.

Where significant risks to the financial statements are identified from our own work, it may be possible to coordinate with the work of internal audit to avoid unnecessary duplication of effort. Where such reliance takes place this will be specifically detailed in the reporting of our results.

Review of IT

Our audit approach assumes that our clients utilise complex computer systems and accounting applications to routinely process large numbers of transactions. These may be used either directly or indirectly in preparing financial reporting information, including the annual accounts. Accordingly, our approach requires a review of the internal controls in the Council's information technology (IT) environment.

Based on our assessment of the complexity of the overall IT environment and the results of an independent review of the IT Shared Services in May 2011, we have involved specialist Technology Risk Services (TRS) team members in our audit work in order to undertake a review of the overall IT control environment. Where significant systems are outsourced, or new systems or applications introduced in year, additional review work may be undertaken on this risk assessed basis.

Internal controls

Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. Therefore, we will focus our control review on the high risk areas of the financial statements.

In order to assess whether controls have been implemented as intended, we will conduct a combination of inquiry and observation procedures, and, where appropriate, transaction walkthroughs. Where further assurance or audit efficiency may be gained, we will consider directly testing any controls that we may consider to be key in relation to the identified risk.

However, our controls work cannot be relied upon to identify all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

Update on accounts audit risk assessment

As part of our planning and control evaluation work we have reviewed the key audit risks identified in our Audit Plan 2011/12 and have set out in Table 1 below the outcome of work completed to date and further work planned.

Our updated review of the key risks facing the Council has not identified any new risk areas.

We will report our full findings and conclusions in respect of each risk identified in our Annual Report to Those Charged with Governance (ISA 260) on completion of our final accounts audit.

Table 1. Key accounting risks and planned assurances

Issue	Audit areas affected	Work completed to date	Further work planned
Accounting for Property, Plant and Equipment	All areas of the financial statements	<ul style="list-style-type: none">Walkthrough testing and tests of controls have been performed on the majority of the Property, Plant and Equipment System, with exception to valuations, impairments and depreciation.	<ul style="list-style-type: none">This work is on-going. The valuations reports was unavailable at the time of the audit and this work has accordingly been scheduled for completion in July 2012.We will work with the Council during our final accounts fieldwork to ensure they have correctly valued and disclosed their heritage assets.

Table 1. Key accounting risks and planned assurances (continued)

Issue	Audit areas affected	Work completed to date	Assurances gained
Control weaknesses in the Council's IT systems are not addressed	All areas of the financial statements	<ul style="list-style-type: none"> A report has been produced on the Status of the IT Shared Service in March 2012. 	<ul style="list-style-type: none"> This work is on-going, a report will be completed in June 2012 updating on the progress of implementation of the recommendations issued in the independent IT review. We will also be conducting our annual review of the overall IT control environment.
Weaknesses within Revenues & Benefits system	All areas of the financial statements	<ul style="list-style-type: none"> Walkthrough testing and test of controls have been performed on the council tax system. 	<ul style="list-style-type: none"> In relation to the council tax system it has been concluded that the controls are operating as documented and at this stage no risks to material misstatement were identified. Further assurance conclusions will be reached with regard to the benefits and national non-domestic rates system during our final accounts fieldwork.

Results of interim audit work

Scope

As part of the interim audit work, and in advance of our final accounts audit fieldwork, we considered:

- the effectiveness of the Internal Audit function;
- internal audit's work on the Council's key financial systems;
- a review of closedown procedures in preparation for the final accounts;
- journal entry controls;
- walkthrough testing and tests of controls to confirm whether controls are implemented as per our understanding in areas where we have identified significant accounting assertion risk; and
- a review of Information Technology controls

The internal audit function

We have reviewed internal audit's overall arrangements against the 2006 CIPFA Internal Audit Standards. Where the arrangements are deemed to be adequate, we can gain assurance from the overall work undertaken by internal audit and can conclude that the service itself is contributing positively to the internal control environment and overall governance arrangements within the Council.

Closedown procedures

Our review considered the Council's timetable for closedown and the arrangements for preparing the draft accounts, including guidance provided on working papers required to be made available as part of the closedown process.

The Council has established a suitable timetable and expects to meet the deadline for submission of the accounts. The Council also expects to be able to provide detailed working papers to support the accounts at the start of our final accounts audit fieldwork, which is scheduled to commence on 16 July 2012, as well as providing the draft Annual Governance Statement and explanatory foreword in advance of this date.

Walkthrough testing and tests of controls

Walkthrough tests and tests of controls were completed in relation to the specific accounts assertion risks which we consider to present a significant risk of material misstatement to the financial statements.

We have not yet been able to complete all our work in the area of property, plant and equipment due to the timing of the availability of the asset valuation report and year end depreciate and impairment calculations. This work has accordingly been scheduled for completion in July 2012 and the results will be considered as part of our accounts audit planning process prior to the commencement of our final accounts audit fieldwork.

No significant issues were noted where walkthrough testing was able to be completed as planned and in-year internal controls were observed to have been implemented and operated satisfactorily in accordance with our documented understanding with exception to one control, detailed below.

We found that the year-end bank reconciliation control for the creditors module within the Academy system was not being prepared on a timely basis. This is a reconciliation between one bank account used for housing benefits payments only, back to the Academy system.

At the end of 2010/11 the year end bank reconciliation was performed and, some assumptions had to be made to complete the reconciliation. In February 2012 a full reconciliation was performed for the 2010/11 year end bank reconciliation. The overall difference between the two reconciliations was less than £5,000.

During 2011/12 a process has been implemented that runs automatic reports, which allows the reconciliation to be completed promptly. This process was put in place from February 2012.

The finance staff were aware that an automatic report running function would be available and therefore took the decision to delay performing reconciliations until the functionality was available. The difference between the manual and automatic year end 2010/11 year end reconciliations was £5,000.

The finance team declined to perform the reconciliations on a monthly manual basis and have elected to perform an automatic year end reconciliation. At this stage this is not deemed a significant risk.

During our final accounts fieldwork we will review the reconciliation for accuracy and completeness and if necessary, report any issues and associated recommendations.

Additional assurance work

To support the audit opinion for 2011/12, we are in the process of undertaking brief reviews in the following areas:

- VAT - a checklist of the Council's current arrangements will be completed to identify whether they are appropriate to ensure VAT is accounted for correctly and in accordance with current legislation
- PAYE - a checklist of the arrangements the Council has in place regarding taxation associated with payroll, including National Insurance and PAYE will be completed in order to provide assurance that figures recorded within the financial statements are true and fair and calculated appropriately and in accordance with current legislation
- Fraud - our forensic team will be reviewing the overall adequacy of the Council's arrangements to ensure that the risk of fraud and corruption is managed effectively.

Any issues identified with the above reviews will be reported where necessary.

Review of information technology controls

Our information systems specialist has yet to perform a review of the general IT control environment, as part of the overall review of the internal controls system. This will be completed in March 2012 and conclusions will be reported thereafter.

Our specialist have also performed a follow up of the issues that have been raised as part of the May 2011 independent review of the IT Shared Service. A quarterly report on our review has been issued in March 2012 and another will be issued in June 2012. At this stage considerations of particular risk areas has been raised with more details and possible recommendations to be reported as part of the June 2012 report.

Journal entry controls

We have reviewed the Council's journal entry policies and procedures as part of determining our journal entry testing strategy and have not identified any material weaknesses which are likely to adversely impact on the Council's control environment or financial statements.

To date we have undertaken detailed testing on journal transactions recorded for the first ten months of the financial year by extracting 'unusual' entries for further review. No issues have been identified that require to be reported.

We will review 'unusual' year end journal entries as part of our final accounts audit and report on any significant issues identified resulting from our work.

Key accounting issues

Asset valuation

Asset valuation should be performed in accordance with IAS 16 'Property, plant and equipment'. There have been changes in the accounting for assets:

- The classification between operational, investment, assets held for sale and surplus assets should be considered to ensure the conditions of the asset use require a change of classification.
- Component accounting, involves the valuation of various components of the asset, there was limited application last year. It will only be required where significant components have different useful lives to the remainder of the asset.

Heritage assets

Heritage assets, the code requires the adoption of heritage assets in 2011/12 for the first time. Heritage assets are to be carried at valuation where possible with requirements for additional disclosures.

Grants

The code has become more stringent on the accounting for grants, particularly in:

- Recognition, the grant amount shall be recognised immediately unless any conditions have not been met.
- Condition, determine if there is a restriction on the use of the grant to be used for a specific purpose. Any grant monies conditions that have not been met will result in the money being repaid.

Whole of government accounts

There has been an increase in accounting requirements surrounding the whole of government accounts ('WGA') submission:

- The unaudited WGA pack is to be submitted in draft format in July with the audited WGA pack being submitted to the CLG by 5 October 2012.
- Infrastructure assets, currently accounted for on a historic cost basis which is not compatible with the valuation basis under WGA, accounts are to continue to be prepared on the same basis but expect more data collection in 2011/12.
- H.M Treasury and Audit Commission to comment on late returns in 2010/11.

Appendices

A. Logistics

Timetables and milestones

The following proposed timetable and deadlines have been set and agreed with management:

Event	Date
Pre year end fieldwork including internal controls review	March 2012
Completion of outstanding internal controls reviews and preliminary housing benefits testing	June 2012
Statutory accounts emailed to auditor	30 June 2012
Commence accounts audit fieldwork	16 July 2012
Partner visit to review work	17 August 2012
Clearance meeting to discuss our findings	24 August 2012
Draft ISA 260 report to be issued by	7 September 2012
Report to Finance Audit Committee (ISA 260)	25 September 2012

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable. An agreed format and schedule of informal update arrangements will be maintained throughout the course of our audit fieldwork in support of this aim.

Engagement team

In accordance with our Audit Plan 2011/12 issued January 2012, the main engagement team for the accounts audit will include:

Name	Role	Contact details
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Information requirements

The information and working paper requirements that would assist us in an efficient and timely audit of the year-end financial statements have been communicated to the finance team within our Arrangements Letter, issued in January 2012.



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