

AGENDA ITEM: 10

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Meeting	Audit Committee
Date	16 June 2011
Subject	Accounts Audit Approach Memorandum
Report of	Deputy Chief Executive & Chief Finance Officer
Summary	This report advises the Committee of Grant Thornton's audit approach and provides an update on results of interim audit work to date.

Officer Contributors	Maria Christofi, Assistant Director Financial Services, Finance Directorate Anisa Darr, Finance Manager (Closing & Monitoring)
Status (public or exempt)	Public
Wards affected	Not applicable
Enclosures	Appendix A – Accounts Audit Approach Memorandum
For decision by	Audit Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not applicable

Contact for further information: Anisa Darr, Finance Manager (020 8359 7106).

1. RECOMMENDATIONS

1.1 That Grant Thornton's Accounts Audit Approach Memorandum be noted.

1.2 That the Committee consider whether there are any areas on which they require additional information or action.

2. RELEVANT PREVIOUS DECISIONS

2.1 None.

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 The audit approach memorandum provides additional detail regarding the audit approach, as set out in the Audit Plan 2010/11. The audit plan assesses fundamental aspects of financial standing and performance management in Barnet, which relates to the council's 'Better Services with Less Money' corporate priority.

4. RISK MANAGEMENT ISSUES

4.1 The audit approach memorandum provides an update on accounts audit risk assessment. If these risks are not taken into consideration it carries the risk of adverse financial and / or reputational consequences.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 The audit approach memorandum covers the inspection and assessment of all services within the authority which, in turn, impact on all members of the community.

6. USE OF RESOURCES IMPLICATIONS (FINANCE, PROCUREMENT, PERFORMANCE & VALUE FOR MONEY, STAFFING, ICT, PROPERTY, SUSTAINABILITY)

6.1 This report sets out the framework for the assessment of the Council's financial reporting, management and standing, as well as value for money.

7. LEGAL ISSUES

7.1 None in the context of this report.

8. CONSTITUTIONAL POWERS

8.1 Constitution Part 3, Section 2 details the functions of the Audit Committee including "To consider the external auditor's annual letter" and "To comments on the scope and depth of external audit work and to ensure it gives value for money".

9. BACKGROUND INFORMATION

- 9.1 The accounts audit approach memorandum intends to provide additional detail regarding Grant Thornton's audit approach, as set out in their Audit Plan 2010/11, as well as an update on their response to key risks from the results of interim audit work carried out to date.
- 9.2 Grant Thornton's audit strategy comprises of:
- Planning: Updating their understanding of the council through discussions with management and a review of the management accounts.
 - Control Evaluation: 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 internal audit against the CIPFA Code of Practice.
 - Substantive Procedures: 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: Performing overall evaluation; determining an audit opinion; reporting to Audit Committee.
- 9.3 Grant Thornton will consider an item to be material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true or fair view.
- 9.4 Grant Thornton will work with internal audit to ensure the audit approach takes account of the risks identified and the work they have conducted, subject to our review of the effectiveness of internal audit.
- 9.6 IT, outsourced systems and internal controls will also be reviewed as part of the audit.
- 9.7 The Audit Approach Memorandum includes as part of its planning and control evaluation an update on audit risks identified for 2010/11, outcome of work completed to date and further work planned. One of the main areas of work completed is that Grant Thornton have substantially completed testing of the 2009/10 figures restated under International Financial Reporting Standards (IFRS).
- 9.8 The updated review of risks facing the council has not identified any new risk areas. However, full findings and conclusions in respect of each risk identified will be reported in the Annual Report to those Charged with Governance (ISA 260) on completion of the final audit.
- 9.9 As part of the interim audit, and in advance of the final accounts audit, Grant Thornton considered:
- The effectiveness of internal audit
 - Internal audit's work on the council's key financial systems

- A review of closedown procedures in preparation for the final accounts under IFRS
 - Review of information technology controls
- 9.10 From Grant Thornton's review no significant issues were identified with internal audit's work, the CIPFA Code had been applied in all significant respects and the work was produced to a satisfactory standard. They can therefore take assurance from the work of internal audit in contributing to an effective internal control environment at the council.
- 9.11 Work completed on testing of journal postings to month 9 have not identified any areas of concern. The final accounts work will include extension of this work to encompass the final quarter and any year end journals processed as part of the preparation of the statement of accounts.
- 9.12 Grant Thornton's information systems specialist has performed a high level review of the internal controls system. The work in this area has been substantially completed and findings will be reported to management in due course.
- 9.13 A review of closedown procedures considered the council's timetable for closedown and the arrangements for preparing the draft IFRS accounts. Grant Thornton found that the council continues to closely monitor the timetable and expects to have the draft accounts prepared well in advance of the submission deadline of 30 June 2011. The council also expects to provide detailed working papers to support the accounts at the start of the final accounts audit visit scheduled for 6th June 2011, approximately two weeks earlier than last year.

10. LIST OF BACKGROUND PAPERS

10.1 None.

Legal: MM

Finance: MC / JH

London Borough of Barnet

Accounts Audit Approach Memorandum

April 2011



Our accounts audit approach

Introduction

This memorandum is intended to provide additional detail regarding our audit approach, as set out in our Audit Plan 2010/11 issued in December 2010, 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 timetables agreed with all staff involved; and
- consider the materiality of transactions when planning our audit and when reporting our findings

The logistic details of our annual accounts audit, as agreed with the Deputy Chief Executive and Chief Financial Officer, are detailed in appendix A to this memorandum.

In summary our audit strategy comprises:

Planning	<ul style="list-style-type: none">• Updating our understanding of the Council through discussions with management and a review of the management accounts
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 effectiveness of internal audit against the CIPFA Code of Practice
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• Determining an audit opinion• Reporting to Audit Committee

Our accounts audit approach (continued)

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, discussed with you and, if you do not adjust, 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 judged material by its nature, for example any item that affects the disclosure of directors' emoluments. An item of higher value may be judged not material if it does not distort the truth and fairness of the financial statements.

Reliance on internal audit

We will work with internal audit to ensure our audit approach takes account of the risks identified and the work they have conducted, subject to our review of the effectiveness of internal audit.

Review of IT and outsourced systems

Our audit approach assumes that our clients use a computer system for accounting applications that process a large number of transactions. Accordingly, our approach requires a review of the Council's internal controls in the information technology (IT) environment.

We have involved Technology Risk Services (TRS) team members during the audit, this was based on the complexity of IT used in the significant transaction cycles and the control risk assessment.

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.

We are also required to assess whether the controls have been implemented as intended. We will do this through a combination of inquiry and observation procedures, and, where appropriate, systems walkthroughs. This is also supported by our review of internal audit reports. However, our work cannot be relied upon necessarily to identify 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 audit risks identified in our Audit Plan 2010/11 and have set out opposite the outcome of work completed to date and further work planned.

Our updated review of the 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.

Issue	Audit areas	Work completed	Further work planned
Accounting under IFRS	All areas of the financial statements	<ul style="list-style-type: none"> Substantially completed testing of the 2009/10 restated figures Review of the draft accounting policies Technical support on specific transactions as required by the Council 	<ul style="list-style-type: none"> Ongoing discussion of emerging issues as they arise during the audit process
Financial performance pressures	All areas of the financial statements	<ul style="list-style-type: none"> Regular discussions with management on financial performance, use of reserves and medium term financial planning 	<ul style="list-style-type: none"> Detailed review of performance for the year against budget Understanding and review of the use of general reserves during the year Review of the medium term financial planning in conjunction with our Value for Money (VfM) work. Substantive audit testing to ensure expenditure and liabilities are recorded in the correct period Discussions surrounding commitments made by the Council and recognition of provisions in the accounts

Update on accounts audit risk assessment (continued)

The specific accounts assertion risks by cycle which we consider to present a 'reasonably possible' risk of material misstatement to the financial statements are detailed in appendix B to this memorandum

Issue	Audit areas	Work completed	Further work planned
Revaluation of fixed assets	Property, plant and equipment	<ul style="list-style-type: none"> • Discussion of the definition of specialised assets for application of the Modern Equivalent Asset (MEA) valuation technique • Sample testing of lease contracts for classification as finance or operating leases • Review of asset reclassifications to investment properties and assets held for sale for compliance with accounting standards 	<ul style="list-style-type: none"> • Ongoing discussion of emerging issues as they arise during the audit process including the use of MEA valuations across the Council's asset portfolio • Detailed testing of property transactions and reclassifications processed during 2010/11 • Review of asset revaluations at 31 March 2011
Implementation of new revenues systems	All areas of the financial statements	<ul style="list-style-type: none"> • Regular discussions with management to understand the implementation process • Preliminary review of the transition arrangements including data reconciliation 	<ul style="list-style-type: none"> • Detailed review of the reconciliation procedures performed to ensure accuracy of the data upon conversion

Update on accounts audit risk assessment (continued)

Issue	Audit areas	Work completed	Further work planned
Use of estimates and judgments	All areas of the financial statements	<ul style="list-style-type: none">• Provided guidance to management identifying the factors which should be considered when making judgements and estimates• Engagement in robust discussions on key areas of judgement within the accounts	<ul style="list-style-type: none">• Detailed review of documented judgements made by management and the support for the decisions made in areas such as provisions• Specific consideration of the indices and assumptions used by the Council for valuation of Council dwellings• Substantive audit testing of debtor balances and expectations for future recovery

Results of interim audit work

Scope

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

- the effectiveness of internal audit
- internal audit's work on the Council's key financial systems
- a review of closedown procedures in preparation for the final accounts under International Financial Reporting Standards (IFRS)
- review of information technology controls

Internal audit

We review 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.

In preparation for our final accounts audit, we reviewed internal audit's work on the financial systems. In assessing the effectiveness of internal audit work, we reviewed three internal audit files to ensure that:

- systems were adequately documented;
- key controls have been identified and evaluated;
- key controls have been tested; and
- weaknesses have been reported to management.

We were pleased to note from our review that no significant issues were identified with internal audit's work, the CIPFA Code had been applied in all significant respects and the work was produced to a satisfactory standard. We can therefore take assurance from the work of internal audit in contributing to an effective internal control environment at the Council.

Journal entry controls

The Council has a policy which defines the controls which are required around journal entry. The authorisation process requires a senior member of staff to authorise journals.

We have completed our testing of journal postings to month 9 and have not identified any areas of concern. Our final accounts work will include extension of this work to encompass the final quarter and any year end journals processed as part of the preparation of the statement of accounts.

Results of interim audit work (continued)

Review of information technology controls

The Council uses SAP, a finance package purchased from and maintained by a third party provider, to administer its accounts. Our information systems specialist has performed a high level review of the general IT control environment, as part of the overall review of the internal controls system. We have substantially completed our work in this area and will report our findings to management in due course.

Closedown procedures

Our review considered the Council's timetable for closedown and the arrangements for preparing the draft IFRS accounts. The Council continues to closely monitor the timetable and expects to have the draft accounts prepared well in advance of the submission deadline of 30 June 2011. The Council also expects to provide detailed working papers to support the accounts at the start of our final accounts audit visit scheduled for 6 June 2011, approximately two weeks earlier than last year.

Our approach to the audit will be to focus on the identified risk areas early in order to resolve any resulting issues promptly. The one exception to this is in the area of Housing and Council tax benefit where there has been a change in IT system during the year. On the request of the Council audit work in this area will not start until 4 July 2011.



Appendices

A. Logistics

Timetables and milestones

The following proposed timetable and deadlines have been set:

Event	Date
Pre year end fieldwork including internal controls review	February 2011
Statutory accounts emailed to auditor	1 June 2011
Commence accounts audit fieldwork	6 June 2011
Manager visits to review work	Throughout June and July 2011
Engagement Lead visits to review work	Throughout June and July 2011
Clearance meeting to discuss our findings	18 July 2011
Report to Audit Committee (ISA 260)	22 July 2011
Clearance of any minor residual audit work identified in the ISA260 (as required)	By 30 July 2011
Audit Committee meeting for approval of the accounts	6 September 2011

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet the accelerated timetable that we have agreed. Key to this is continuous close working between our teams including timely provision of all required working papers and explanations from the Council and rapid turnaround on audit issues from Grant Thornton.

Engagement team

In accordance with our Audit Plan 2010/11 issued December 2010, the main engagement team for the accounts audit will include:

Name	Role	Contact details
Paul Hughes	Engagement Lead	T: 020 7728 2256 E: paul.hughes@uk.gt.com
Tom Foster	Audit Manager	T: 020 7728 2085 E: thomas.foster@uk.gt.com
Melanie Fox	Assistant Manager	T: 020 7728 2419 E: melanie.fox@uk.gt.com
Simon Cooke	Audit Senior	T: 0207 728 2790 E: simon.j.cooke@uk.gt.com

Information requirements

The information and working paper requirements that would assist us in an efficient and timely audit of the year-end financial statements will be communicated to the finance team within our Arrangements Letter, to be issued April 2011.

B. Accounts assertion risks by cycle

A reasonably possible risk is defined as being where:

- Numerous and often very precise controls should be established by management
- Substantive procedures would vary if controls were tested
- Inherent risk factors increase the likelihood of a material misstatement

All of these risks will be addressed through performance of walkthroughs to verify that controls are implemented

Property, plant and equipment

Valuation - Gross

Risks

Property, plant and equipment activity not valid

Revaluation measurements not correct

Valuation - Net

Risks

Property, plant and equipment are impaired

Allowance for depreciation no adequate

Completeness

Risks

Finance leases may not be correctly accounted for

Housing benefit & council tax benefit expenditure

Completeness

Risks

Expenditure may not be complete or accurate

Council tax

Completeness

Risks

Tax revenue transactions not recorded

Existence

Risks

Recorded debtors not valid

Valuation - Net

Risks

Allowance for doubtful accounts not adequate

B. Accounts assertion risks by cycle (continued)

Operating expenses

Completeness

Risks

Creditors understated or not recorded in correct period

HRA Rental Revenue

Valuation - Net

Risks

Allowance for doubtful accounts not adequate

Other Revenues

Valuation - Net

Risks

Recorded debts not recoverable



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