

Ryedale District Council

Report to the Overview and Scrutiny Committee on the 2011 Audit Planning

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Executive summary

We have pleasure in setting out in this document details of our proposed audit plan for Ryedale District Council (“the Council”) for the year ending 31 March 2011.

Audit scope

This document is in relation to the proposed external audit of Ryedale District Council. The audit is to be undertaken in accordance with International Standards on Auditing (UK and Ireland) as adopted by the UK Auditing Practices Board and as required under our contract with the Audit Commission.

On 2 June the Audit Commission announced proposals that the audits currently undertaken by their in-house practice should be outsourced to the private sector for the year ended 31 March 2013 onwards.

Audits already outsourced, like this Council, are unaffected by this announcement.

Consultation on the proposals for the new audit framework (where “audit quality is regulated within a statutory framework, overseen by the National Audit Office and the accountancy profession and where local public bodies will be free to appoint their own external auditors with stringent safeguards for independence”) closes on 30 June 2011 when proposals will be published in a draft bill to allow full Parliamentary scrutiny.

Key audit risks

The key audit risks which we have identified as part of our overall audit strategy are:

1. changes to the accounting framework;
2. changes to the revenue and benefits system;
3. valuation of fixed assets;
4. adequacy of bad and doubtful debt provisioning;
5. pension scheme assumptions;
6. accounting for share of partnership assets and liabilities;
7. presumed risk of revenue recognition fraud; and
8. presumed risk of management override of controls.

Further details of the specific risk are set out in section 2 of this report.

Findings from the planning visit

We have substantially completed our planning visit. At this time there are no specific observations that we would want to bring to the attention of those charged with governance.

We are still to perform our review of the IT environment and we will provide detailed feedback on the issues arising in the year under review and an update on the matters identified in the prior year in due course.

We will provide an update on the control points identified for the year ended 31 March 2010 as part of our report on the findings of our audit for the year ended 31 March 2011, which will be presented to the Overview and Scrutiny Committee in September 2011.

Executive summary (continued)

Value for money audit - Financial resilience and prioritisation of resources

From 2010/11 the Audit Commission has introduced new requirements for local value for money (“VFM”) audit work at councils. This year, auditors are required to give their statutory VFM conclusion based on the following two criteria:

- proper arrangements in place for securing financial resilience: work to focus on whether the Council has robust systems and processes to manage risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future; and
- proper arrangements for challenging how economy, efficiency and effectiveness is secured: work to focus on whether the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We determine our local programme of work based on our risk assessment, which is informed by a series of risk factors determined by the Audit Commission.

The key audit risk which we have identified as part of our overall audit strategy is the delivery of financial targets and the management of the reduction in financial resources.

More detail is given in section 5 of this report.

Materiality

Materiality levels are calculated on the basis of total gross expenditure for the year. We estimate materiality based on 2010/11 revenue budget to be £428,000 (2010: £386,813).

We will report to the Overview and Scrutiny Committee on all unadjusted misstatements greater than £8,560 (2010: £7,736) and smaller misstatements if they are qualitatively material

More details of these calculations are given in section 1 of this report.

Other matters for those charged with governance

We have communicated to you separately in our publication entitled “Briefing on Audit Matters”, circulated with this document, those additional items which we are required to report upon in accordance with International Standards on Auditing (UK & Ireland). The document also provides detail of the safeguards and procedures we have in place to ensure our independence and objectivity.

We confirm we are independent of the Council and will reconfirm our independence and objectivity to the Overview and Scrutiny Committee for the year ending 31 March 2011 in our final report to the Overview and Scrutiny Committee.

Executive summary (continued)

Timetable

This year's timetable comprises the following:

- a planning visit in March 2011;
- a review of the IFRS transition work in April 2011;
- a review of the IT environment in June 2011; and
- a final visit lasting 4-5 weeks starting 25 July 2011. This will include a review of the restated IFRS financial statements.

Our value for money work will also be carried out in April 2011 and in the period July to September 2011.

The findings from the final visit will be presented at the Overview and Scrutiny Committee meeting in September 2011.

The audited financial statements and the Whole of Government Accounts ("WGA") return must be approved and submitted by 30 September 2011.

1. Scope of work and approach

We will conduct our audit in accordance with International Standards on Auditing (UK and Ireland) (“ISA (UK and Ireland)”) as adopted by the UK Auditing Practices Board (“APB”) and the Code of Audit Practice. Our audit objectives are set out in our “Briefing on audit matters” document, circulated with this document.

The audit opinion we intend to issue will reflect the financial reporting framework required of Local Authorities and as set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 based on International Financial Reporting Standards.

For the 2011 financial statements, we have used the latest budgeted gross expenditure as the benchmark for our materiality assessment as this statistic, in our view, represents the most appropriate measure of the scale of the organisation and, therefore, best reflects the context within which any misstatements should be considered.

In accordance with our established methodology we have calculated a monetary indicator of materiality by applying a sliding scale factor to the budgeted gross expenditure. For the current year this factor has been calculated as approximately 1.32% (2010: 1.38%) which gives planning materiality of £428,000 (2010: £386,813) based on information provided by Officers. We will update our calculation at the year end when we receive the draft financial statements. We will report any change in materiality to the Overview and Scrutiny committee in our final report in September 2011.

This assessment takes into account our knowledge of the organisation, our assessment of audit risks and the reporting requirements for the financial statements. The concept of materiality and its application to the audit approach are set out in our Briefing on Audit Matters document, circulated with this document.

The extent of our procedures is not based on materiality alone but also on local considerations of the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

2. Key audit risks

Based upon our initial audit risk assessment and following our planning visit, we will concentrate specific audit effort on the following areas:

1. Changes to the accounting framework

Risk & Response The financial statements of all Councils are required to comply with the accounting requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 based on International Financial Reporting Standards ("IFRS"). There are various changes, required as a consequence of the transition to IFRS, which will affect balances in the accounts such as leases, fixed assets, deferred grants and employee benefits. The comparative figures for the year ended 31 March 2009 and 2010 are required to be retrospectively reworked on this new basis and the financial statements will include a prior period restatement in respect of this change in the accounting framework. There is a risk that some of the changes in the accounting framework may be overlooked or misinterpreted.

At our visit in April 2011 we reviewed the initial conversion work that has been performed by the finance team on the 2009 and 2010 balances in respect of the main changes noted above. We noted that some areas of this work were incomplete at that time, such as, the restatement of property plant and equipment.

We will review the restated accounts as part of our final audit process. During our audit work in July and August 2011 we will revisit the key conversion areas noted above in respect of the 2011 balances.

2. Changes to the revenue and benefits system

Risk & Response The revenue and benefits system was changed to the Northgate application in February 2011. The system went live from 18 February 2011. There is a risk that data may not have been migrated correctly from the old to the new system and that data may be incorrectly recorded due to lack of experience on the new system.

Internal Audit are due to perform a review of the migration to Northgate and the controls set up in this application during 2011/12.

Our IT team will review the controls put in place by the Council to manage the migration of data from Civica to Northgate as part of their planned work in June 2011.

We will perform a review of the completeness and integrity of the year end listing of benefits debtors as part of our consideration of the recoverability of this balance.

2. Key audit risks (continued)

3. Valuation of fixed assets

Risk & Response In the current climate the property market is still volatile and there is the potential for valuations of property and other assets to have fallen.

There is also a new requirement under IFRS for all new or revalued fixed assets with component parts, which may have different useful lives, to be reviewed and the components to be depreciated at different rates according to their useful lives. This requirement applies prospectively from 1 April 2010.

We will obtain a copy of the third party valuation report and review a sample of the valuations for arithmetic accuracy. We will use our in-house property department to review the basis of the valuations for reasonableness based upon their market knowledge and experience. We will consider whether there is indication of any impairment from the third party valuations and whether any noted impairment should be applied more widely to other assets that have not been valued in the current year.

For the IFRS requirement of componentisation, we will perform a review of the process for identifying components for new and revalued assets and the associated depreciation charge calculation.

4. Adequacy of bad and doubtful debt provisioning

Risk & Response In the current climate there is likely to be more pressure on the Council's rate-payers' financial resources. It therefore follows that there is likely to be a higher level of unpaid debts at the balance sheet date and potentially more bad and/or doubtful debts occurring.

We will document the process the Council has in place for reviewing and providing against bad and doubtful debts owed to the Council at the balance sheet date. We will review the calculation of the year end provision and consider the adequacy of the provision in the light of available evidence including the aging profile of debtors at the year end and at the time of audit, the history of bad debt exposure, recent changes in payment profile and post year-end cash receipts against year-end debtor balances.

5. Pension scheme assumptions

Risk & Response In the current climate the choice of pension inflation, discount and yield assumptions will be both difficult and judgemental. Small and apparently insignificant changes to these key assumptions can have material consequences for the actuarial assessment of the liability included within the financial statements of the Council. During 2010/11 the North Yorkshire Pension Fund went through a triennial valuation which may also impact on the key assumptions.

We will document the process the Council has put in place to determine the assumptions and will use our in-house pension and actuarial department to review these assumptions for reasonableness based upon prevailing market factors.

2. Key audit risks (continued)

6. Accounting for share of partnership assets and liabilities

Risk & Response The Council utilises a number of partnerships (for example Building Control Partnership) for the provision of services to residents and businesses. A risk exists regarding the completeness of such information given the operations of the partnership is outside of the Council's direct control.

We will review management's process to ensure that they obtain all information regarding partnership assets and liabilities in a prompt manner and reflect them appropriately in the financial statements.

7. Presumed risk of revenue recognition fraud

Risk & Response International Standards on Auditing (UK and Ireland) 240 – "The auditor's responsibility to consider fraud in an audit of financial statements" requires the auditors to perform certain audit procedures related specifically to fraud risk, and requires a presumption that revenue recognition is a key audit risk.

For the Council we consider that the specific revenue recognition risk relates to the non-recognition of cash receipts as income, or their recognition in the wrong accounting period.

We will perform testing by selecting a sample of cash receipts and confirming that all income received was correctly recognised as income in the financial statements in the appropriate period. In addition, testing of grant income will be performed to ensure that the new provisions of IFRS have been consistently applied.

8. Presumed risk of management override of controls

Risk & Response International Standards on Auditing (UK and Ireland) requires the auditors to perform certain audit procedures to respond to the risk of management's override of controls.

We will perform the following:

- understand and evaluate the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, and test the appropriateness of a sample of such entries and adjustments;
- review accounting estimates for biases that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of management;
- a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and
- obtain an understanding of the business rationale for significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the organisation and its environment.

3. Internal control

Obtaining an understanding of internal control relevant to the audit

As set out in the "Briefing on audit matters" circulated with this document, for controls considered to be 'relevant to the audit' we are required to evaluate the design of the controls and determine whether they have been implemented ("D & I").

This includes reviewing controls relating to the financial reporting process, reconciliation of ledgers, the preparation of the financial statements and other reports, the reporting and processing of journals, the segregation of duties, related parties and key audit relevant general computer controls.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the organisation, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

Liaison with internal audit

We have and will continue to liaise with the Council's internal audit function on a constructive and complementary basis to maximise our combined effectiveness and eliminate duplication of effort. This co-ordination will enable us to derive full benefit from the Council's internal audit function, its systems documentation and risk identification during the planning of the external audit to the extent we determine we can rely on their work.

The audit team, following an assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function, will review the findings of any relevant internal audits on the Council and adjust the audit approach as is deemed appropriate. Where internal audit identifies specific material deficiencies in the control environment, we will consider adjusting our testing so that any new additional specific audit risks are covered by our work.

4. Consideration of fraud

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

We have made initial inquiries of the following parties regarding fraud:

Management	Internal audit	Those charged with governance
<p>Management's assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments.</p> <p>Management's process for identifying and responding to the risks of fraud in the entity.</p> <p>Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.</p> <p>Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.</p> <p>Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.</p>	<p>Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.</p>	<p>How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.</p> <p>Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.</p>

We will make inquiries of others as appropriate. We will also inquire into matters arising from your whistle blowing procedures. We will ask for you and management to make the following representations towards the end of the audit process:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the council and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the council's financial statements communicated by employees, former employees, analysts, regulators or others.

5. Value for money (VFM)

Based upon our initial assessment, we will concentrate specific effort on the key audit risk set out below. Our risk assessment will however be revisited during the course of our audit, for example when 2010/11 outturn and 2011/12 quarter 1 budget and performance monitoring information is available. Any changes to our risk assessment will be reported in our final report to the Overview and Scrutiny Committee in September 2011.

Delivery of financial targets and the management of reduction in financial resources

Risk & Response Following the Government's comprehensive spending review and the extent of the reduction in the funding settlement announced in December 2010, the Council is facing severe financial pressures over the next few years. Work is still ongoing by management to develop further measures to achieve the financial funding gap in 2012/13.

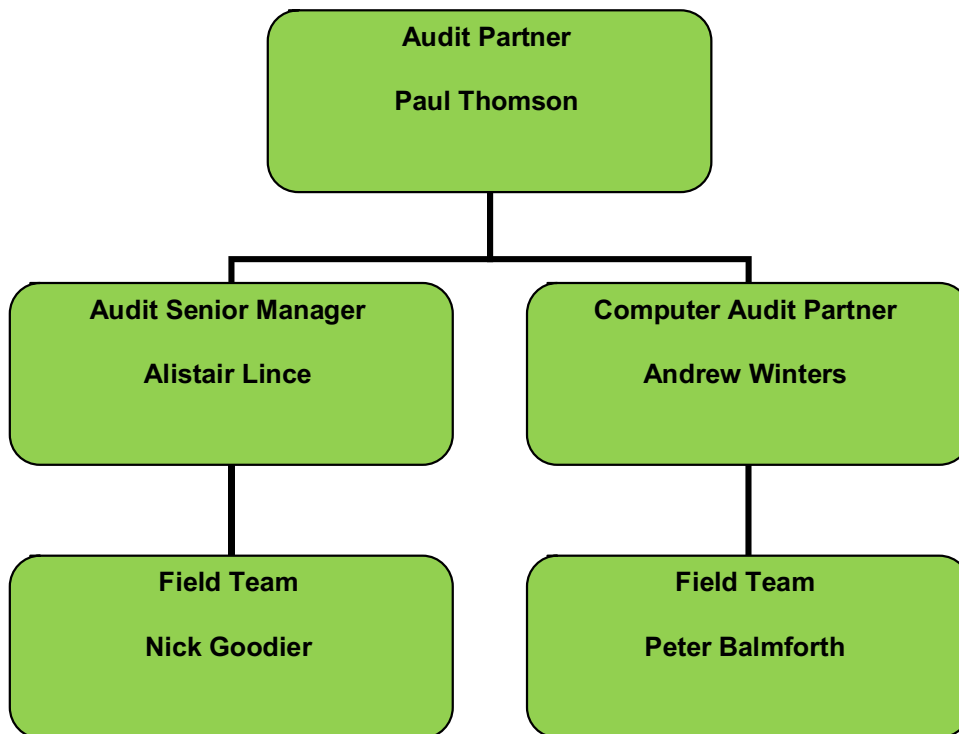
We will review the risk assessments for the savings proposals in the 2011/12 budget derived from the One-11 programme and arrangements for the ongoing management of those risks. Progress in developing plans for 2012/13 will also be monitored. During the course of this work, we will consider the effectiveness of arrangements to assess the implications of savings measures and to manage their impact on the delivery of strategic priorities.

We will also select a sample of initiatives to assess the reasonableness of the quantification of savings to be achieved, and the processes for identifying and addressing any costs of implementation.

We will maintain a watching brief over delivery of the savings plans and performance against budgets.

6. Client service team

We set out below our audit engagement team.



7. Responsibility statement

This report sets out those audit matters of governance interest which have come to our attention during the planning of our audit to date. Our audit is not designed to identify all matters that may be relevant to you and our final report on the audit will not necessarily be a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

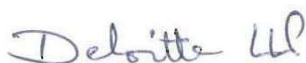
The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audit bodies by summarising, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do. Responsibility for the adequacy and appropriateness of these methodologies and data rests with the Audit Commission.

Our report has been prepared on the basis of, and our work carried out in accordance with, the Code and the Statement of Responsibilities.

While our report includes suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of Ryedale District Council's system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion, which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

We view this report as part of our service to you for use, as Members, for corporate governance purposes and it is to you alone that we owe a responsibility to its contents. We accept no duty, responsibility or liability to any other parties as the report has not been prepared, and is not intended, for any other purpose. It should not be made available to any other parties without our prior written consent.

If you intend to publish or distribute financial information electronically or in other documents, you are responsible for ensuring that any such publication properly presents the financial information and any report by us thereon, and for the controls over and security of the website. You are also responsible for establishing and controlling the process for electronically distributing accounts and other information.



Deloitte LLP

Chartered Accountants

Leeds

28 June 2011

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