

# Audit plan

Lancashire County Council

Audit 2011/12



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# Introduction

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

## **Responsibilities**

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

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

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

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

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

# Accounting statements and Whole of Government Accounts

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

## Materiality

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

## Identifying audit risks

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

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

## Identification of significant risks

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

Table 1: **Significant risks**

Risk	Audit response
<p><b>Waste PFI scheme commencement</b></p> <p>The Council's waste PFI scheme became operational during 2011/12 and the Council's accounts for 2011-12 will now reflect the asset and corresponding liability on the balance sheet. This requires a professional assessment of the unitary payment to the contractor between its capital and revenue elements to ensure it is correctly recognised and accounted for within the balance sheet. The nature of the contract and the related technical guidance is complex, increasing the risk of a material misstatement occurring. The Council has used external consultants specialising in PFI schemes to support it in this respect.</p>	<p>Review of external financial advice on PFI transactions</p> <p>Test of detail on the value of assets and liabilities recognised to underlying records and on unitary payment, including splitting the unitary payment into its component parts</p>
<p><b>Implementation of new payroll system</b></p> <p>The Council implemented a new payroll system during 2010-11. This covers a large proportion of the Council's expenditure. In addition to the risks of material error linked to the implementation of any new major financial system, problems have occurred resulting in the misclassification of payroll expenditure within the Council's ledger. These are being corrected via journals on an ongoing basis whilst action is being taken to correct the system faults.</p>	<p>Review of management oversight of checking the transfer of standing data from the old to the new payroll system</p> <p>Review of management oversight of the arrangements for correcting the mis-coding of payroll costs and ensuring budget monitoring is still effective in the light of the miscoding problems</p> <p>Test of detail on the migration of information from the old payroll system to the new payroll system</p> <p>Tests of detail on payroll costs and use of predictive analytical review to gain assurance over overall payroll costs</p>
<p><b>Production of group accounts</b></p> <p>The Council has not produced group accounts since 2005/06 on the basis that whilst there are a number of organisations which would form part of its group, group accounts were judged not to be material to the Council's financial statements. Following the creation of One Connect Ltd in 2011/12, the Council has now determined that group accounts will</p>	<p>Review management's consideration of the group boundary and any decisions about the entities to include in the group accounts.</p> <p>Review of management's oversight of the consolidation process</p> <p>Reliance on auditors of group entities</p> <p>Tests of detail of the consolidation adjustments and supporting notes</p>

## Risk

need to be prepared for 2011/12. This will require close liaison with the relevant entities within the group, adjustments to take into account different accounting policies which may exist between them, different methods of consolidation depending on the nature of the Council's relationships with the entities. Particularly in the first year, there is a risk of material misstatement arising.

### **Valuation of property, plant and equipment (PPE)**

The Authority is required to value PPE at fair value (with some exceptions). At 31/3/2011 these were valued at £2,427m. Valuation of these assets is undertaken by qualified valuers on the instructions of the Council. The nature of such valuations involves a high degree of subjectivity bringing with it an inherent risk of mis-statements of the valuations.

### **Pension asset and liability estimates**

The Council had a net pensions liability at 31 March 2011 of £765m. This liability represents the extent to which the present value of liabilities exceeds the fair value of assets. This has a substantial impact on the net worth of the authority as recorded in the Balance Sheet.

Liabilities have been assessed on an actuarial basis using the projected unit credit method, an estimate of the pensions that will be payable in future years dependent on assumptions about mortality rates, salary levels etc. The liabilities have been assessed by Mercers, an independent firm of actuaries, using the latest full valuation of the scheme as at 31 March 2010 adjusted for current information about membership numbers, current pay levels etc. The resultant estimated figures involve a high degree of subjectivity and small changes in the assumptions used can have a material impact on the financial

## Audit response

Review of controls over establishing estimates, including arrangements for instructing your valuer

Procedures for reliance on the work of the valuer

Tests of detail on valuations ensuring they are supported by valuations which have been calculated in accordance with the council's instructions and associated depreciation calculations ensuring they reflect the latest valuer's estimate of asset value and asset life.

Review of controls over ensuring that the actuary has sufficient and accurate information on which to make his estimates

Procedures for reliance on the work of the actuary including, as in previous years, using the Audit Commission's appointed expert to review the work of all local government pension fund actuaries

Tests of detail to ensure that the accounts correctly reflect the actuarial estimates of assets and liabilities

statements.

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## Group accounts

I am responsible for the direction, supervision and performance of the group audit. I intend to contact the auditors of the following entities as part of my audit procedures.

- Lancashire County Developments Ltd
- One Connect Ltd

Please discuss with me any concerns about me contacting these auditors.

## Overall testing strategy

My audit involves:

- in line with international auditing standards, review and re-performance of work of your internal auditors to the extent to which I judge this to be necessary given my assessment of the effectiveness of internal audit
- testing of the operation of controls;
- reliance on the work of other auditors;
- reliance on the work of experts; and
- substantive tests of detail of transactions and amounts.

I have sought to:

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

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

Table 2: Proposed work

	Review of internal audit	Controls testing	Reliance on the work of other auditors	Reliance on work of experts	Substantive testing
Pre-statements work	General ledger Payroll Accounts payable	Accounts receivable Cash receipting SIMs WOSPs			Payroll Investment – in-year transactions PPE – in year additions Waste PFI accounting model
Post statements work			One Connect Ltd – PWC and Lancashire County Developments Ltd – Grant Thornton, consolidated within the Council’s group accounts	Pensions liabilities and assets – Mercers and our own consulting actuary Valuation of property, plant and equipment - County Council’s property services team	All material accounts balances and amounts Year-end feeder system reconciliations

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

### Whole of Government Accounts

Alongside my work on the accounting statements, I will also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report are specified by the National Audit Office.]



# Value for money

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

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

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

## Identification of Value for Money risks

I have considered the risks relevant to my Value for Money (VfM) conclusion. I have identified the following areas where I need to complete further work to support my conclusion. I do not expect to issue any separate audit output for this work but will report the basis for my conclusions within my Annual Governance Report in September 2012.

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Table 3: **VFM risks**

Risk	Audit response
<p><b>Financial planning and delivery</b></p> <p>The Council has responded well to the current financial climate and is delivering successfully on its financial plans. However, bridging future funding gaps remains a challenge as the Council will also have to respond to the uncertainties over future funding and expenditure demands.</p>	<p>Continue to monitor developments through:</p> <ul style="list-style-type: none"><li>■ review of budget monitoring reports, 2012-13 budget reports, updates to the medium term financial strategy</li><li>■ review of performance monitoring reports</li><li>■ ongoing liaison with chief officers</li></ul>

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Risk	Audit response
<p><b>Waste Management</b></p> <p>Waste management has been identified as a financial pressure and the Council is currently looking at a range of options to address this risk. An annual savings target of £10m is required by the Council.</p>	<p>Monitor developments in this area including review of:</p> <ul style="list-style-type: none"> <li>■ option appraisals and modelling</li> <li>■ use of relevant expertise</li> <li>■ related risk assessments and responses</li> </ul>
<p><b>BT Partnership/One Connect Contract performance</b></p> <p>As part of the Council's approach to delivering financial savings whilst improving services it entered into a strategic partnership arrangement with British Telecom (BT). The partnership involves the creation of One Connect Ltd to deliver a range of core back office services to the County Council. The guaranteed cumulative financial benefits to the County Council over the lifetime of the contract (10 years) are over £100 million. Effective and close monitoring of the delivery of agreed performance standards and financial targets is crucial.</p>	<p>Review of the Council's approach to monitoring the delivery of agreed performance standards and financial targets through:</p> <ul style="list-style-type: none"> <li>■ review of relevant monitoring reports to cabinet and its sub-committee</li> <li>■ discussions with relevant officers</li> <li>■ review of payments to One Connect Ltd during 2011/12</li> <li>■ review of any variations to the contract or wider agreement if they arise</li> </ul>
<p><b>Treasury management</b></p> <p>To reduce net financing costs whilst also reducing financial risk, the Council has moved away from a relatively simple and traditional approach to Treasury Management. The new strategy is more complex and requires an ability to monitor and react more quickly to market developments than in previous years. We have made recommendations to officers to improve the governance of this more complex environment.</p>	<p>Follow up of developments within Treasury Management including actions taken to address our previous recommendations.</p>

# Key milestones and deadlines

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

Table 4: **Proposed timetable and planned outputs**

Activity	Date	Output
Opinion: controls and early substantive testing	January – June 2012	Annual Governance report and progress report to audit committee
Opinion: receipt of accounts and supporting working papers	30 June 2012	
Opinion: substantive testing	July – September 2012	Annual Governance Report
Value for money	January – August 2012	Annual Governance Report
Present Annual Governance Report at the Audit Committee	26 September 2012	Annual Governance Report
Issue opinion and value for money conclusion	By 30 September 2012	Auditor's report
Summarise overall messages from the audit	October 2012	Annual Audit Letter

# The audit team

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

Table 5: **Audit team**

Name	Contact details	Responsibilities
Karen Murray District Auditor	k-murray@audit-commission.gov.uk 0844 798 7041	Responsible for the overall delivery of the audit including quality of reports, signing the auditor's report and liaison with the Chief Executive.
Fiona Blatcher Senior Audit Manager	f-blatcher@audit-commission.gov.uk 0844 798 7056	Manages and coordinates the different elements of the audit work. Key point of contact for the Treasurer.

# Independence and quality

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## Independence

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

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

## Quality of service

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

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

# Fees

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**The fee for the audit is £251,100, as set out in my letter of 15/4/2011**

## **The audit fee**

The Audit Commission has set a scale audit fee of £251,100 which represents a 10 per cent reduction on the audit fee for 2010/11.

The scale fee covers:

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

The scale fee reflects:

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

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

## **Assumptions**

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

## Specific actions you could take to reduce your audit fee

The Audit Commission requires me to inform you of specific actions you could take to reduce your audit fee. I have not identified any actions that you could take to reduce your fee for 2011/12.

## Total fees payable

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

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

Based on current plans the fees payable are as follows.

Table 6: Fees

	2011/12 proposed	2010/11 actual	Variance
	£	£	£
Audit	251,100	279,000	27,900
Certification of claims and returns	7,200	20,000(estimate)	12,800
Non-audit work	0	0	0
<b>Total</b>	<b>258,300</b>	<b>299,000</b>	<b>40,700</b>

In recent years the Audit Commission has issued rebates on the main audit fees. This was the case for 2010-11 and in 2011/12. The net affect of the rebates is that the net cost to the Council of the main audit in 2010-11 was £246,669 and is expected to be £231,012 in 2011/12.



# Appendix 1 – Independence and objectivity

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

Table 7: **Independence and objectivity**

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

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

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

# Appendix 2 – Basis for fee

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In setting the fee, I have assumed the following:

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

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

# Appendix 3 – Glossary

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## **Accounting statements**

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

## **Annual Audit Letter**

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

## **Annual Governance Report**

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

## **Annual Governance Statement**

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

## **Audit of the accounts**

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

## **Audited body**

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

## **Auditing Practices Board (APB)**

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

## **Auditing standards**

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

## **Auditor(s)**

Auditors appointed by the Audit Commission.

## **Code (the)**

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

## **Commission (the)**

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

## **Ethical Standards**

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

## **Group accounts**

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

## **Internal control**

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

## **Materiality**

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

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

## **Significance**

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

## **Those charged with governance**

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

## **Whole of Government Accounts**

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

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

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

