

London Borough of Haringey

Accounts Audit Approach Memorandum

March 2012

Contents

1. Our accounts audit approach	2
2. Update on accounts audit risk assessment	4
3. Results of interim audit work	10

Appendices

A. Logistics	13
B. Action plan	14

Our accounts audit approach

This memorandum is intended to provide additional detail regarding our audit approach, as set out in our Audit Plan 2011/12 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 Assistant Director of Finance, are detailed in Appendix A to this memorandum.

Planning

- 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

Controls 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 selected controls
- Assessing the Council's arrangements for complying with tax legislation and Bribery Act requirements
- Assessing the effectiveness of Internal Audit

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 of our work on the financial statements to determine whether they give a true and fair view
- Determining an audit opinion
- Reporting to the Corporate 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.

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, 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.

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 identified additional risks, which are detailed in Table 2 alongside our planned audit response.

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 under IFRS	All areas of the financial statements	<ul style="list-style-type: none"> Developing IFRS accounting issues have been discussed at our local government technical training which Council officers attended. We have maintained ongoing liaison with the Council's Finance Team regarding emerging IFRS issues and guidance. 	<ul style="list-style-type: none"> We will continue to maintain ongoing liaison with the Finance Team regarding emerging issues and new guidance released up until the signing of the 2011/12 financial statements. Our substantive audit procedures will focus on the high risk areas identified as a result of the transition to IFRS, in particular property, plant and equipment (PPE).

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

Issue	Audit areas affected	Work completed to date	Further work planned
<p>Financial performance pressures</p>	<p>All areas of the financial statements</p>	<ul style="list-style-type: none"> • We have monitored the Council's financial position throughout the year through review of Cabinet papers and liaison meetings with the Director of Corporate Resources. • The Council has to achieve significant savings in the next financial period. This could impact on the level of reserves held by the Council and therefore the assessment of the going concern assumption when preparing the annual financial statements. 	<ul style="list-style-type: none"> • We will undertake procedures on revenue and expenditure to ensure that they have been accounted for in the correct year and are a complete representation of the Council's revenue and expenditure for the year. • We will carry out an updated review of the Council's financial position as part of our going concern procedures.
<p>Accounting for Property, Plant and Equipment</p>	<p>All areas of the financial statements</p>	<ul style="list-style-type: none"> • There is inconsistency in the way local authorities account for schools' non-current assets and expenditure. Some authorities have foundation and voluntary assisted schools on their balance sheets and some do not. CIPFA is currently consulting on this issue. We have provided the Council with the information available to date on accounting for schools. • Under the 2011/12 Accounting Code the Council is required to disclose heritage assets as a separate category of assets for the first time in its 2011/12 accounts. We have had discussions with the Council on the methodology adopted to identify the Council's heritage assets. The Council will need to ensure once identified, the heritage assets are revalued as part of the valuation program. 	<ul style="list-style-type: none"> • We will continue to liaise with the Council regarding its proposed treatment of schools and adopt a pragmatic approach when a degree of judgement is required. • We will review the Council's working papers and disclosure on heritage assets as part of the accounts audit work.

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

Issue	Audit areas affected	Work completed to date	Further work planned
Revaluation of Non-current assets	Property, plant and equipment	<ul style="list-style-type: none"> Based on discussions with management, work has been undertaken by the Valuations team to carry out valuations based on the guidance provided by the Royal Institute of Chartered Surveyors (RICS) and the Code to ensure these are in line with IFRS. We have also had discussions with officers to ensure that the valuation basis for assets is appropriate, for example assets not in use since the civil disturbances are not valued at market value if not held for sale. 	<ul style="list-style-type: none"> The use of valuation experts will be reviewed, to ensure that valuations have been completed in accordance with relevant IFRSs, in particular: <ul style="list-style-type: none"> - the appropriateness of data and instructions provided to the expert - the methods and assumptions applied by the expert. We will review the Council's progress against PPE recommendations raised from the 2010/11 audit to ensure these have been addressed.
Depreciation of Council dwellings	Property, plant and equipment	<ul style="list-style-type: none"> In previous years, the Council has used the Major Repairs Allowance (MRA) as a proxy for depreciation. This will not be possible under the new self-financing HRA regime from 2012/13, although there will be a transition period. The Council needs to prepare for this. Based on discussions with officers, the Council intends to continue to use MRA as a proxy for depreciation for 2011/12 in line with guidance and work is underway in 2012/13 to move to componentised depreciation accounting. They do not expect that the depreciation based on the MRA will be materially different from depreciation calculated using conventional methods. We have discussed with the Council the need to calculate depreciation based on accounting standards. 	<ul style="list-style-type: none"> We will review the valuation of Council dwellings as part of our work to ensure it is in line with guidance issued. The Council will need to demonstrate that the depreciation based on the MRA is not materially different from depreciation calculated using conventional methods.
Components	Property, plant and equipment	<ul style="list-style-type: none"> Componentisation of PPE is prospective. As this is the second year of IFRS we would expect the amount of componentisation to increase, particularly in respect of HRA expenditure. We have discussed componentisation of PPE with the Council and understand there have been ongoing discussions with the Valuation team. 	<ul style="list-style-type: none"> We will review the Council's methodology for identifying and accounting for components in 2011/12 for both council dwellings and all other non-current assets where applicable.

Accounts Audit Approach Memorandum

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

Issue	Audit areas affected	Work completed to date	Further work planned
Alexandra Park and Palace Trust (AP&P)	Group accounts consolidation	<ul style="list-style-type: none"> As in 2010/11, the Council will need to prepare group accounts that include AP&P. Based on discussions with the Council, AP&P plan to have their accounts audited in July 2012 and the Council has included this in its closedown timetable. 	<ul style="list-style-type: none"> We will liaise with the auditors of AP&P to inform our planning and review the consolidated accounts as part of the accounts audit.
HRA Self Financing	All areas of the financial statements	<ul style="list-style-type: none"> From 2012/13, the DCLG are introducing a devolved and local system of financing for council housing whereby councils are able to manage their own stock using their own rents. This is achieved via a one-off debt settlement. Based on the Council's calculations, the capital valuation of projected income and expenditure over the 30 year period of the HRA business plan is higher than the debt supported by the HRA subsidy. The Council will receive £232m from the DCLG on 28 March 2012 and we have discussed with the Council how this should be accounted for based on the guidance available. 	<ul style="list-style-type: none"> We will review the basis of the self-financing valuation figured calculated by the Council to gain assurance over this figure and the accounting entries for the HRA settlement to ensure this is in line with the guidance.
Use of estimates and judgements	All areas of the financial statements	<ul style="list-style-type: none"> We have discussed the requirements for disclosures and supporting evidence for estimates and judgements within the financial statements including asset valuations, HRA depreciation, allowances, prepayments, accruals and provisions. 	<ul style="list-style-type: none"> In line with the requirements of the 'Clarity' ISAs, we will review the calculation for each significant estimate and judgement included in the financial statements. We will review any assumptions made in respect of these for reasonableness including the impact of any identified estimation uncertainties.

Accounts Audit Approach Memorandum

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

Issue	Audit areas affected	Work completed to date	Further work planned
Fraud	All areas of the financial statements	<ul style="list-style-type: none"> We have had discussions with various officers at the Council including the Head of Internal Audit & Risk Management and the Head of Legal to obtain information on the arrangements in place for fraud and corruption. We continue to liaise with Internal Audit on the questions from the public regarding alleged frauds at schools and to date no significant issues has been noted in regards to the counter-fraud arrangements in place for schools. 	<ul style="list-style-type: none"> We will discuss our findings with management and report these to those charged with governance as part of our ISA 260.
Whole of Government Accounts (WGA)	All areas of the financial statements	<ul style="list-style-type: none"> There were delays in completing our work on WGA in 2010/11 as the Council, along with many other local authorities, submitted them for review after the deadline. We have agreed with the Council that the unaudited WGA will be completed and submitted to us for review by the required deadline. 	<ul style="list-style-type: none"> We plan to complete our work on the WGA once we have completed our accounts audit work and report our findings on the WGA work in our ISA 260.
Reduction in Finance function	All areas of the financial statements	<ul style="list-style-type: none"> We have had ongoing discussions with the Finance team to reach early agreement on the accounting treatment for any emerging issues. We have reviewed progress against our 2010/11 accounts post-mortem action plan and to date there are no significant delays in implementing any of the agreed actions. However we are still waiting to agree the format of the accounts receivable and payable working papers which was an agreed action. 	<ul style="list-style-type: none"> Our audit work will initially focus on high risk areas to ensure the Council has sufficient time to provide any additional information requested and resolve any queries raised as part of our work.

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

Issue	Audit areas affected	Work completed to date	Further work planned
<p>Control weaknesses in the Council's IT systems are not addressed</p>	<p>All areas of the financial statements</p>	<ul style="list-style-type: none"> We have completed our work on IT systems as part of the overall review of internal control systems. No material weaknesses have been identified that are likely to adversely impact the Council's financial statements. See page 11 for further details. 	<ul style="list-style-type: none"> No further work planned.

Table 2. Additional key accounting risks identified and planned assurances

Issue	Audit areas affected	Audit approach
Accounting for Academies	Property, plant and equipment	<ul style="list-style-type: none"> • During 2011/12 two of the Council's schools have transferred to Academies and from discussions with the Council there are four more schools being considered as Academies. • We have discussed the accounting entries and disclosures requirements for the schools which became Academies in the year based on guidance provided by CIPFA. The Council will also need to consider the valuation basis for schools which it has been agreed will become academies in 2012/13. • The Council will also need to ensure that adequate disclosures for these schools are included in the accounts for 2011/12.
Accounting for government grants	All areas of the financial statements	<ul style="list-style-type: none"> • As per the Code grants and contributions should not be recognised until there is reasonable assurance that the Council will comply with the conditions attached to them and the grants will be received. Where conditions are met the Council should recognise the grant immediately. • The Council will need to determine whether there is a condition or restriction attached to the grant, determine if these have been met or not and there is reasonable assurance that the grant will be received. This will determine how the Council accounts for the grants in 2011/12.

Other matters

We noted that the Head of Internal Audit and Risk Management stepped in to manage the Control Centre during the civil disturbances over the summer in 2011. This was in effect an operational role, albeit under extenuating circumstances. In the absence of the Director of Corporate Resources between March and September 2012, the Head of Internal Audit and Risk Management will also be overseeing the relationship with Alexandra Park & Palace, although there are arrangement in place to ensure that she has no operational role. The Head of Internal Audit should not have operational duties as this may comprise her independence. We will review the arrangements in place for AP&P to ensure the Head of Internal Audit does not have an operational role.

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;
- 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.

Overall, we have concluded that the Internal Audit service continues to provide an independent and satisfactory service to the Council and that we can take assurance from their work in contributing to an effective internal control environment at the Council.

We reviewed three internal audit files to ensure that recommendations raised in our 2010/11 audit had been implemented. Based on the work completed, we did not identify any issues from our review of the files.

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 4 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.

No significant issues were noted and in-year internal controls were observed to have been implemented and operate satisfactorily in accordance with our documented understanding.

Review of information technology controls

Our information systems specialist performed a high level review of the general IT control environment, as part of the overall review of the internal controls system. We have also performed a follow up of the issues that have been raised in the previous year. We concluded that, from the work undertaken to date, there are no material weaknesses which are likely to adversely impact on the Council's financial statements.

We have, however, identified one area where improvements could be made which we have included in the action plan in appendix B. We do not consider this to pose a significant risk to the accounts, and have reported our findings to management through our interim audit feedback meeting.

Additional assurance work

To support the audit opinion for 2011/12, we have undertaken brief reviews in the following areas:

- VAT - a checklist of the Council's current arrangements is in the process of being completed to identify whether they are appropriate to ensure VAT is accounted for correctly and in accordance with current legislation. We will include coverage of the findings of this review within our ISA260 report to those charged with governance.
- PAYE - a checklist of the arrangements the Council has in place regarding taxation associated with payroll, including National Insurance and PAYE is in the process of being 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. We will include coverage of the findings of this review within our ISA260 report to those charged with governance.
- Fraud - our forensic team is in the process of reviewing the overall adequacy of the Council's arrangements to ensure that the risk of fraud and corruption is managed effectively. We will include coverage of the findings of this review within our ISA260 report to those charged with governance.

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 commencement of housing benefits testing	June 2012
Statutory accounts emailed to auditor	30 June 2012
Commence accounts audit fieldwork	4 July 2012
Partner visit to review work	20 August & 12 September 2012
Clearance meeting to discuss our findings	tbc
Draft ISA 260 report to be issued by	Sept 2012
Report to Corporate Committee (ISA 260)	Sept 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
Paul Dossett	Engagement partner	T: 0207 728 3180 E: paul.dossett@uk.gt.com
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Kate Wheeler	Audit Senior	T: 0207 728 2033 E: kate.e.wheeler@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 have been communicated to the finance team within our Arrangements Letter, issued in March 2012.

B. Action plan

Priority

High - Significant effect on control system

Medium - Effect on control system

Low - Best practice

Rec No.	Recommendation	Priority	Management Comments	Implementation date and responsibility
1	<p>SAP User Account Management (Leavers' process) The Financial Systems Team obtains a leavers' list from HR every 1-2 months. The list is compared to that of users who are on SAP to identify if any leavers still have access to the Financial system. Leavers' access is terminated by entering an end-date in the SAP application.</p> <p>This process however results in untimely deactivation of leavers' access to the system. There is a potential delay of about 30-60 days, at most, between the actual date of a person leaving and when the related leaver account is disabled.</p> <p>Without timely notification of leavers, there is a risk that user accounts are susceptible to unauthorised use which means potential access and manipulation to information within the finance system.</p> <p>Recommendation Management should ensure that the process put in place to notify finance of leavers is on a timely basis. Hence, we recommend that the notification period of the leavers' list to Financial Systems Team should not be more than one week. This will ensure that only current employees of the Authority have access to the SAP system.</p>	Low	<p>Discussions will be held with HR to improve the current process.</p> <p>The issue of an end to end starter and leaver process generated from the SAP HR system is one that has been investigated and can only be addressed by relevant SAP supported software and is something that is being pursued as part of the OneSAP project.</p>	<p>July 2012 (review of current process)</p> <p>Automated process is dependent on the ONE SAP procurement.</p> <p>Gary Jude (Systems Manager)</p>



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