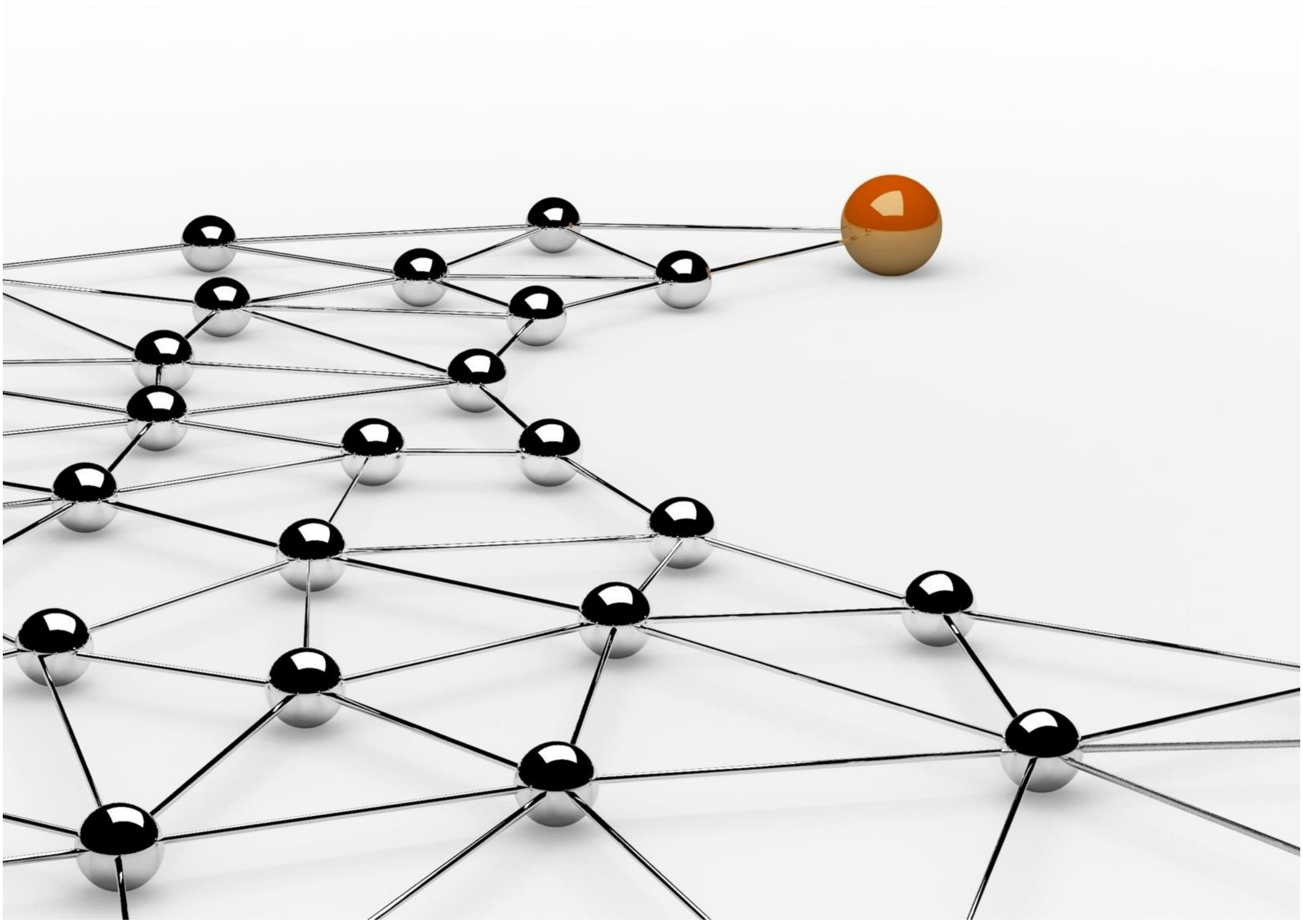
Audit Strategy Memorandum

City of York Council – year ending 31 March 2015

March 2015



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Audit and Governance Committee
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12 March 2015

Dear Members

Audit Strategy Memorandum for the year ending 31 March 2015

We are pleased to present our Audit Strategy Memorandum for City of York Council for the year ending 31 March 2015.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. It is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, and Appendix A summarises our considerations and conclusions on our independence as auditors.

We value two-way communication with you and we see this document, which has been prepared following our initial planning discussions with management, as being the basis for a discussion through which we can also understand your expectations.

This document will be presented at the Audit and Governance Committee meeting on 25 March 2015. If you would like to discuss any matters in more detail please do not hesitate to contact me on 07979 164467.

Yours faithfully

Gareth Davies
Partner
Mazars LLP

Contents

01 Purpose and Background

Purpose of this document

This document sets out our audit plan in respect of the audit of the financial statements of City of York Council for the year ending 31 March 2015, and forms the basis for discussion at the Audit and Governance Committee meeting on 25 March 2015.

The plan sets out our proposed audit approach and is prepared to assist you in fulfilling your governance responsibilities. The responsibilities of those charged with governance are defined as to oversee the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process.

We see a clear and open communication between ourselves and you as important in:

- Reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- Sharing information to assist each of us to fulfil our respective responsibilities;
- Providing you with constructive observations arising from the audit process; and
- Ensuring as part of the two-way communication process that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks facing City of York Council which might affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

Appendix C outlines the form, timing and content of our communication with you during the course of the audit. Appendix D sets out forthcoming accounting and other issues that will be of interest.

Scope of engagement

We are appointed to perform the external audit of City of York Council for the year to 31 March 2015. The scope of our engagement is laid out in the Audit Commission's Code of Audit Practice for Local Government bodies.

Responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out our respective responsibilities as 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 we undertake our audit work to meet these responsibilities.

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

- Audit Commission Act 1998; and
- Code of Audit Practice for Local Government bodies.

We, as auditors to City of York Council, are responsible for forming and expressing an opinion on the financial statements and reaching a conclusion on the arrangements you have put in place to secure economy, efficiency and effectiveness in the use of your resources (the Value for Money conclusion).

We are also required to report on the consistency of your Whole Government Accounts submission with the audited financial statements.

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

The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK and Ireland) we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as whole are free from material misstatement, whether caused by fraud or error. However our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

Significant matters considered

As part of our risk based approach to planning we consider a number of key performance and control environment features together with external developments. The following paragraphs set out some of the key aspects for 2014/15.

Performance and control environment

We use the Council's latest financial monitoring reports and medium term financial plan to consider the current financial position.

Ongoing pressure on the public finances presents significant challenges for the Council and the need to plan for further reductions in spending power at a time of increasing demand for services.

In 2014/15 and 2015/16 the Council expects to deliver a total of £22.4m in savings. This is on top of the total of £51m savings already achieved in the period 2010/11 to 2013/14.

The following table summarises in year financial activity to date.

Area	Budget	Projected year end position	Projected overspend / (underspend)
2014/15 Net revenue expenditure	£124.2m	£125.0m	£0.8m
2014/15 Capital expenditure	£72.6m	£66.2m	(£6.4m)

Based on the third quarter review, the latest budget forecasts for 2014/15 indicate a projected net revenue overspend of £0.8m.

The Council has a range of earmarked reserves for specific plans and projects that will help the Council to deliver its priorities. These reserves provide some flexibility if the Council needs to invest to save, for example, but there is a recognition that reserves cannot be used to sustain services and the underlying budget reductions identified will need to be delivered.

External developments

The Council has to prepare its financial statements in line with CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom. There have been a number of changes to the Code for 2014/15 which include:

- changes to group accounts standards IFRS10 consolidated financial statements, IFRS11 joint arrangements and IFRS12 disclosure of interests in other entities – possible changes to accounting treatment due to changes in definition of control and classification; and
- accounting for schools with continuing debate about the impact of a change in the single entity definition, new CIPFA guidance and the need to disclose critical judgements.

02 Audit scope, approach and timeline

Audit scope

Our audit approach is designed to provide you with an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards of Auditing (UK and Ireland) and in accordance with the Code of Audit Practice for Local Government Bodies. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement such as those impacted by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

Audit approach

We apply a risk-based audit approach primarily driven by the matters we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment we develop our audit strategy and design audit procedures in response to this assessment. The work undertaken will include a combination of the following as appropriate:

- Testing of internal controls;
- Substantive analytical procedures; and
- Detailed substantive testing.

If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view. Materiality and misstatements are explained in more detail in Appendix B.

The diagram overleaf outlines the procedures we perform at the different stages of the audit.

Planning

- Planning visit
- Risk assessment
- Considering proposed accounting treatments and accounting policies
- Developing audit strategy
- Agreeing timetable and deadlines
- Preliminary analytical review

Interim work and final fieldwork

- **Interim work**
- Document systems and controls
- Perform walkthroughs
- Interim controls testing

- **Final fieldwork**
- Receiving and reviewing draft financial statements
- Reassessment of audit plan and revision if necessary
- Executing the strategy starting with significant risks and high risk areas
- Communicating progress and issues
- Clearance meeting

Completion

- Final review and disclosure checklist of financial statements
- Final Engagement Lead review
- Agreeing content of letter of representation
- Reporting to the Audit and Governance Committee
- Reviewing post balance sheet events
- Signing the auditor's report

Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work of internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

Reliance on other auditors

There are material entries in your financial statements where we will seek to place reliance on the work of other auditors, having performed our own audit procedures to determine its adequacy for our audit.

Item of account	Other auditor	Nature of assurance to obtain from the auditor
Defined benefit liability and associated IAS 19 entries and disclosures	North Yorkshire Local Government Pension Fund Auditor (Deloitte)	Accuracy of data supplied to the pension fund actuary by the pension fund

Service organisations

We have not identified any material entries in your financial statements where the Council is dependent on an external organisation.

The work of experts

We plan to rely on the work of the following experts:

Items of account	Management's expert	Our expert
Defined benefit liability and associated IAS 19 entries and disclosures	Actuary (Mercer)	Audit Commission's consulting actuary (PWC)
Property, plant and equipment valuations	Your internal valuer	Audit Commission's consulting valuer (Gerald Eve)

Timeline

The diagram below sets out the timing of the key phases of our audit work. We will communicate with management throughout the audit process and will ensure significant issues identified are communicated to those charged with governance on a timely basis.

Jan – March 15

- Planning meeting
- Issue Audit Strategy Memorandum

Jan – Jun 2015

- Interim work (walk through tests, control testing, IT risk assessment)
- Report interim findings and update Audit Strategy Memorandum if required – June

Jul – Sep 2015

- Start fieldwork on 1 July 2015
- Issue Audit Completion Report
- Clearance meeting

30 Sept 2015

- Issue representation letter
- Finalise financial statements review and issue auditor's report
- WGA reporting

03 Significant risks

We have performed our planning procedures, including risk assessment, as detailed in section 2. In addition, we met with management as part of the audit planning process to discuss the risks that, in management's opinion, the Authority faces and have considered the impact on our audit risk. The risks that we identify as significant for the purpose of our audit are the risks of material misstatement that in our judgement require special audit consideration.

We set out below the significant audit risks and the areas of management judgement identified as a result of these meetings and planning procedures which we will pay particular attention to during our audit in order to reduce the risk of material misstatement in the financial statements.

Audit risks

Management override of controls
Description of the risk International Standards on Auditing (ISA) 240 – *The auditor's responsibility to consider fraud in an audit of financial statements* requires us to consider the potential for management override because controls that may be sufficient to detect error may not be effective in detecting fraud. In all entities, management at various levels is in a unique position to perpetrate fraud because of the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.
How we will address this risk We will address this risk through performing audit work on: • consideration and review of accounting estimates impacting amounts included in the financial statements; • consideration and review of any unusual or significant transactions outside the normal course of business; and • journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Revenue recognition

Description of the risk

In accordance with ISA 240 we presume there is a risk of fraud in respect of the recognition of revenue because of the potential for inappropriate recording of transactions in the wrong period. ISA 240 allows the presumption to be rebutted but, given the Council's range of revenue sources we have concluded that there are insufficient grounds for rebuttal in 2014/15. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.

How we will address this risk

We will evaluate the design and implementation of controls to mitigate the risk of income being recognised in the wrong period. We will also undertake a range of substantive procedures including:

- testing receipts in March and April 2015 to ensure they have been recognised in the right year;
- testing adjustment journals;
- obtaining direct verification of material grant income amounts; and
- obtaining direct confirmation of year-end bank balances and testing the reconciliations to the ledger.

Pension Estimates (IAS 19)

Description of the risk

The financial statements contain material pension entries in respect of retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.

How we will address this risk

We will discuss with key contacts any significant changes to the pension estimates prior to the preparation of the financial statements. In addition to our standard programme of work in this area, we will:

- evaluate the management controls you have in place to assess the reasonableness of the figures provided by the Actuary; and
- consider the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned annually by the Audit Commission.

Property, plant and equipment – accounting for depreciation, revaluations and impairments

Description of the risk

Accounting standards and CIPFA's Code of Practice on Local Authority Accounting require that all property, plant and equipment are depreciated, unless there is a specific exception. There are also requirements to regularly revalue assets carried at fair value on the Council's balance sheet and to carry out impairment reviews. The accounting entries to reflect property, plant and equipment are complex and a material error was identified and corrected in the 2013/14 financial statements.

How we will address this risk

We will specifically review the accounting entries to ensure that depreciation, revaluations and impairments are properly reflected in the financial statements.

Follow up of 2013/14 audit issues

We will follow up the work undertaken by officers to address issues raised in our 2013/14 Audit Completion Report:

- resolving the outstanding issues with the bank reconciliation;
- reviewing assets under construction and ensuring the accounts are updated appropriately; and
- reviewing leases to ensure they are correctly reflected in the financial statements.

04 Value for Money Conclusion

We are required to reach a conclusion on your arrangements to secure economy, efficiency and effectiveness in the use of your resources.

Our conclusion on your arrangements is based on two criteria, specified by the Audit Commission:

- securing financial resilience – focusing on whether you are managing your financial risks to secure a stable financial position for the foreseeable future; and
- challenging how you secure economy, efficiency and effectiveness – focusing on whether you are prioritising your resources within tighter budgets and the need to improve productivity and efficiency.

We set out below the significant risks that we will address through our work.

Responding to the financial pressures
Description of the risk The Council faces financial pressures from reduced funding and continues to identify plans to deliver future savings. Without robust budgetary control and delivery of its action plans, the Council's financial resilience and service performance could deteriorate. There have been some high profile examples of problems with project delivery. Most recently, the Council is considering whether to continue its long-running housing for older people procurement and has begun to consider a new strategy.
How we will address this risk We will review: • the budget process and the Medium-Term Financial Strategy; • the progress made in identifying savings required; • progress of the Council's Transformation Programme; • budget monitoring reports and other finance updates; • delivery of improved outcomes; and • whether project management practices are robust and lessons are being learned from difficult experiences.

Risks in relation to adult social care services

Description of the risk

We identified weaknesses in budgetary control and financial management in adult social care services in the 2013/14 audit and this led to an 'except for' qualification of the VFM conclusion. The risk is that the measures taken by the Council to address the issues raised last year are not effective.

How we will address this risk

We will follow up on the work undertaken in adult social care to ensure that previously agreed actions have been implemented. We will consider how well the service is responding to a large number of challenges, such as preparing for Care Act implementation, increasing demand (ageing population and high proportion of over 85s in York), reducing resources, and the extent to which it has taken the opportunity to improve overall outcomes through working with partners, such as Vale of York CCG through the Better Care Fund.

05 Your audit team

Below are your audit team and their contact details.

Engagement lead / Partner	• Gareth Davies • gareth.davies@mazars.co.uk • 07979 164 467
Engagement senior manager	• Gavin Barker • gavin.barker@mazars.co.uk • 0191 561 1917 or 07896 684 771
Team leader	• David Hurworth • david.hurworth@mazars.co.uk • 0191 383 6300

06 Fees for audit and other services

Our audit fees for the audit of the financial statements and for any assurance or other services are outlined in the tables below.

Area of work	2014/15 Proposed fee	2014/15 Scale Fee	2013/14 Actual fee
Code audit work	£135,476	£135,476	£148,546
Certification work	£15,220	£15,220	£18,304
Total fee	**£150,696**	**£150,696**	**£166,850**

All fees exclude VAT

Non-audit work

We have already completed the following non-audit service as part of the 2014/15 audit:

- Review of teachers' pensions return, £2,750 (excluding VAT)

We do not currently plan any further non-audit services, and no other audit or non-audit services are provided to the Authority by Mazars LLP associated entities. If additional non-audit work is identified we will report this to the Audit and Governance Committee in our regular audit progress reports.

In 2013/14, non-audit work amounted to £21,000 (excluding VAT).

Appendices

Appendix A - Independence

We are required by the Financial Reporting Council to confirm to you at least annually in writing that we comply with the Auditing Practices Board's Ethical Standards. In addition we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement:

- there are no relationships between us and any of our related or subsidiary entities, and
- you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- All partners and staff are required to complete an annual independence declaration;
- All new partners and staff are required to complete an independence confirmation and also complete computer based ethical training;
- Rotation policies covering audit engagement partners and other key members of the audit team who are required to rotate off a client after a set number of years; and
- Use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement lead.

We wish to confirm that in our professional judgement, as at the date of this document, we are independent and comply with UK regulatory and professional requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Gareth Davies.

Prior to the provision of any non-audit services Gareth Davies will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

No threats to our independence have been identified. As in previous years we undertake certification work on grants for the Council and we are satisfied that we have appropriate safeguards in place and this does not compromise our independence.

Appendix B – Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole.

Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

We have set materiality at the planning stage at £7.06m with a clearly trivial threshold of £212k below which identified errors will not usually be reported. We have set lower materiality levels for the disclosure of officer remuneration and emoluments and members’ allowances as we consider these items to be of specific interest to users of the accounts sufficient to warrant audit procedures which would not otherwise be applied based on the materiality level for the audit as a whole. The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

We discuss with management any significant misstatements or anomalies that we identify during the course of the audit and we report in our Audit Completion Report all unadjusted misstatements we have identified other than those which are clearly trivial, and obtain written representation that explains why these remain unadjusted.

Appendix C – Key communication points

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require us to communicate a number of points with you.

Relevant points that need to be communicated with you at each stage of the audit are outlined below.

Form, timing and content of our communications
We will present to the Audit and Governance Committee the following reports:

- Our Audit Strategy Memorandum;
- Our Audit Completion Report; and
- Annual Audit Letter

These documents will be discussed with management prior to being presented to the Audit and Governance Committee and their comments will be incorporated as appropriate.

Key communication points at the planning stage as included in this Audit Strategy Memorandum

- Our responsibilities in relation to the audit of the financial statements;
- The planned scope and timing of the audit;
- Significant audit risks;
- Our independence;
- Responsibilities for preventing and detecting errors;
- Materiality; and
- Fees for audit and other services.

Key communication points at the completion stage to be included in our Audit Completion Report

- Significant deficiencies in internal control;
- Significant findings from the audit;
- Significant matters discussed with management;
- Our conclusions on the significant audit risks;
- Unadjusted misstatements;
- Management representation letter;
- Our proposed draft audit report; and
- Independence.

Key communication points at the completion stage to be included in our Annual Audit Letter
The purpose of this document is to summarise the outcome of the audit of the 2014/15 annual accounts, our work on the value for money conclusion and to consider some of the key challenges for the future.

Appendix D – Forthcoming accounting and other issues

The 2014/15 CIPFA Code of Practice on Local Authority Accounting (the Code) has made several changes, of which you should be aware. We provided workshops explaining these changes and invited officers from the Council responsible for preparing the financial statements. The workshops provided full details of the changes in the 2014/15 Code as well as a forward look to potential future accounting changes that may be of relevance to the Authority. If you require detailed information on any of these changes or any other emerging issues, please contact any member of the engagement team.

Forthcoming accounting issues

Accounting for schools	How this may affect the Council
The 2014/15 Code has changed the way in which local authorities must account for maintained schools. The income, expenditure, assets, liabilities, reserves and cash flows of all local authority maintained schools must now be included in the Council's own single entity accounts for the first time. Where the impacts of this are material, the previous year's statements must be restated to take account of the change.	Members may be aware that CIPFA has been looking into the accounting treatment for schools assets (principally school buildings) as a result of a continuing qualification on the Whole of Government Accounts arising from the inconsistent recognition of these assets on local authority balance sheets. CIPFA has issued guidance to Councils for 2014/15 in relation to the assessment and subsequent accounting for schools assets. We have discussed this guidance with officers to identify the Council's intentions in relation to the recognition of maintained schools assets
Transport infrastructure assets	**How this may affect the Council**
It is anticipated that the measurement basis for the Council's Transport Infrastructure Assets will change from depreciated historic cost to depreciated replacement cost in 2016/17, with prior period restatement required. It is likely that the impact of this change will be significant and that the value of these assets on the Council's balance sheet will significantly increase.	We are aware that the Council has been doing work to meet the significant challenges that it faces in introducing this change in measurement basis and we have engaged with them at an early stage to provide advice and assistance where required.
Early deadlines	**How this may affect the Council**
The Government had signalled its intention to bring forward the deadlines for local authorities to produce their unaudited statements of account to 31 May from the 2017/18 financial year. The deadline for the completion of the audit will also move forward to 31 July.	The impact of this change on local authorities and their auditors are significant and we have begun to discuss how we will meet the challenges the new dates place on us all with Council officers.

Group Accounts	How this may affect the Council
Module 9 of the 2014/15 Code Guidance Notes has been updated to reflect changes in group accounting standards.	The Council does not currently prepare Group Accounts, but this may change as more joint working arrangements are introduced.
Property, Plant and Equipment (PPE)	**How this may affect the Council**
The 2014/15 Code Guidance Notes have clarified requirements for regular valuations of property, plant and equipment set out in IAS 15.	Whilst the Code allows 5-yearly valuations it makes it clear that the requirement to ensure that carrying values are materially correct takes precedence. This means that the valuer needs to provide evidence that the value of PPE at 31 March 2015 is not materially different from the date of the last physical valuation. This could include reference to appropriate indices, sample valuations and impairment reviews.
Fair Value accounting from 2015/16	**How this may affect the Council**
IFRS 13 sets a new framework for determining fair values from 1 April 2015.	No impact on 2014/15. However, if any assets are held as surplus assets from 2015/16 onwards (e.g. vacated premises) they will need valuing at market value rather than existing use value.