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Financial Statements Audit Plan 2010/11

Wiltshire Council

February 2011

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This report is addressed to the Council and has been prepared for the sole use of the Council. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Chris Wilson, the engagement leader for the Council (telephone: 0118 964 2269, email: christopher.wilson@kpmg.co.uk) who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees (0161 236 4000, email trevor.rees@kpmg.co.uk), who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to: complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421

Summary

Our audit is divided into:

- **use of resources;**
- **financial statements.**

This document describes how we will deliver our financial statements audit work for Wiltshire Council.

Our statutory responsibilities and powers are set out in the Audit Commission Act 1998, the Local Government Act 1999 and the Audit Commission's Code of Audit Practice (the Code).

The Audit Commission's Code summarises our responsibilities into two objectives, requiring us to review and report on your:

- *financial statements* (including the Annual Governance Statement): providing an opinion on your accounts; and
- *use of resources*: concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The Audit Commission's Statement of Responsibilities of Auditors and Audited Bodies sets out the respective responsibilities of the auditor and the Council. The table below summarises the work we will do this year.

Our responsibility	Risks, proposed work and output
Financial Statements & Annual Governance Statement	The key audit risk this year relates to the implementation of International Financial Reporting Standards (IFRS). Local authorities are implementing FRS in 2010/11, including re-stating prior period figures. This will result in some fundamental differences in accounting and will require significant planning to ensure your financial statements reflect the new standards (see page 6 for more details). Our work will encompass: ■ A specific IFRS re-statement audit early in the audit process to consider a number of IFRS implementation issues, particularly the re-statement of prior year figures and opening balances on the balance sheet, in advance of the main audit process. ■ Review of the controls over the completion of the accounts. We will rely on Internal Audit where possible to avoid duplication. ■ A detailed audit of the financial statements, associated disclosure notes and the Annual Governance Statement. Our audit will also consider a number of other specific audit risks relating to issues such as the Council's SAP system, accounting for schools and the current financial pressures the Council faces. **The findings of this work support the audit opinion that we issue on your financial statements.**
Use of Resources / Value for Money work	In response to the changing financial environment, the Audit Commission has introduced a new approach to local value for money (VFM) work at those bodies previously subject to a use of resources (UoR) assessment. The new, more focused and risk-based approach will reduce the work auditors do, to the minimum necessary to meet their statutory VFM responsibilities. Our work will encompass: ■ A risk assessment to identify the amount and focus of local VFM work. ■ Where applicable, undertaking local VFM work to address the risks identified in the risk assessment. **The findings of this work will inform our value for money conclusion.**

The audit planning and risk assessment is an on-going process. The risk assessment and fees in this plan will be kept under review and updated if necessary. The remainder of this document provides details of our risk assessment and proposed work for our financial statements audit. It supplements the high level audit plan presented earlier in 2010. A separate Audit Plan will be issued for the pension fund audit.

Our separate VFM audit plan summarises the approach we will follow this year for our UoR audit responsibilities.

Audit overview

We undertake our work on your financial statements and Annual Governance Statement (AGS) in four key stages.

Our work results in our audit opinion on your financial statements.

We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We are required to provide an audit opinion on the accounts.

We are also required to satisfy ourselves that your AGS is consistent with our understanding of your operations. Our review of the work of internal audit and consideration of your risk management and governance arrangements are key to this opinion.

In addition to the Council's financial statements, we are also required to audit and provide an opinion on the Whole of Government Accounts return submitted to central government.

Our audit process

We have summarised the four key stages of our financial statements audit process for you below:

			Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
1	Planning	Perform risk assessment procedures and identify risks	○								
		Determine audit strategy	○								
		Determine planned audit approach	○								
2	Control evaluation	Understand accounting and reporting activities		●	○						
		Evaluate design and implementation of selected controls		●	○						
		Test operating effectiveness of selected controls		●	○				○		
		Assess control risk and Risk of Material Mis-statement (RoMM)		●	○				○		
3	Substantive procedures	Plan substantive procedures		●					○	○	
		Perform substantive procedures		●					○	○	
		Consider if audit evidence is sufficient and appropriate		●					○	○	
4	Finalisation	Perform completion procedures									○
		Perform overall evaluation									○
		Form an audit opinion									○
		Audit Committee reporting			○			○			○

Key: ○ Main financial statements audit
● IFRS re-statement audit

Audit overview (cont.)

We work with your finance team and internal audit team to enhance the efficiency of the accounts audit.

Our audit process (cont.)

As part of our audit process, we will work closely with the finance team to understand and continually improve the accounts production process. At the planning stage of our audit we will issue the Council with a ‘prepared by client’ list which will include a detailed schedule of information requests to support the financial statements. This year, for the first time, we will make use of KPMG’s KClient system which allows the Council’s finance team to share working papers with us electronically through a secure portal.

Our audit procedures also include an assessment of your arrangements to deliver your responsibilities to prevent and detect fraud. The auditing standard for fraud, ISA240 (revised), responds to the increased sensitivity to fraud and the importance given to auditors’ work on fraud. Additionally, the Fraud Act 2006 and the Government Review of Fraud 2006 may impact on your responsibilities to manage fraud.

Liaising with internal audit

We have a strong working relationship with Internal Audit and we will continue to work closely with them to maximise the effectiveness of their work on core financial systems and governance at the Council.

International Financial Reporting Standards (IFRS)

All Local Authorities are required to implement IFRS for 2010/11 financial statements, moving away from the previous UK GAAP based accounting regime. We will continue to work closely with the finance team to ensure the smooth transition to IFRS. We will audit the re-stated 2009/10 balances early in the audit process to provide assurance on key aspects of your IFRS migration work, identify any issues on a timely basis and also ensure some accounting and audit effort is brought forward to alleviate the busy closedown and final accounts audit season over the summer.

Whole of Government Accounts (WGA)

We are required to review and report on your WGA consolidation pack in accordance with the approach agreed with HM Treasury, the National Audit Office and the Audit Commission. The 2010/11 WGA consolidated pack will need to be produced in accordance with the International Financial Reporting Standards (IFRS).

National Fraud Initiative

The Council participates in the National Fraud Initiative, which is the Audit Commission’s computerised data matching exercise designed to detect fraud perpetrated against public bodies. During our audit we will review the Council’s progress and actions in following up the matches identified.

Audit overview (cont.)

Local electors have certain rights to raise questions with the auditor.

Elector challenge

The Audit Commission Act 1998 gives electors certain rights. These are:

- the right to inspect the accounts;
- the right to ask the auditor questions about the accounts; and
- the right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on any elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised. The costs incurred in responding to questions or objections raised by electors are not part of the fee. If required, such work will be charged in accordance with the Audit Commission's fee scales.

Key financial statement audit risks

These are the key financial statement risks identified for 2010/11 and some examples of other risks that we will consider during the audit. We seek to tailor our audit approach to reflect this risk assessment.

We have increased our risk assessment in the following area:

- **Implementation of IFRS (see pages 8 to 10); and**
- **Accounting for Schools (see page 11).**

External

Known/stable ← → **Changing/new**

Equal pay	Valuation of investments	Provisions and impairments	Consolidations and associates
Accounting for PFI arrangements	Impact on asset values due to economic conditions	Contingent assets/liabilities	Property, Plant and Equipment
Financial instruments	Accounting for Schools	Implementation of IFRS	Income collection
Whole of government accounts	Risk of external fraud	Financial standing/MTFP	Leases
Financial management	Risk of internal fraud	Exceptional costs	Severance costs
Annual governance statement	Members allowances	Financial systems (SAP)	Employee benefits

Internal

Key:
- Matters with potential financial statement risk
- Matters of high audit risk discussed further on page 6

The above risk assessment has been completed in January 2011 and will be revisited before the final audit commences to update for any new or increasing risks. It is not intended to be a complete or exhaustive list of audit risks, rather it provides information to the Council on some of the likely areas that will require more detailed attention during the audit.

Key financial statement audit risks (cont.)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

Transitions to IFRS represents the largest change in accounting for a number of years. We have detailed within the next slides the major implications of the new standards and how our audit work will be adapted to address these key risks.

Key audit risks		Impact on audit plan
IFRS conversion process	**Audit areas affected** Re-stated opening balances. Various balances and disclosures within 2010/11 financial statements.	**Impact of IFRS implementation** The transition to IFRS represents the largest change in accounting for a number of years. This will require a lot of planning and resources by the Council to ensure a smooth and successful transition to IFRS. **Our audit work** We will audit the re-stated 2009/10 financial statement figures in February. During this time we will assess the processes being undertaken by the Council and provide advice on how this can be improved to ensure the final years figures are compliant with the standards. We will keep in regular contact with the finance team during this period, discussing emerging issues and current guidelines. During the final accounts audit we will audit all figures in line with IFRS. Some of the key areas of change associated with the implementation of IFRS are discussed below.
Leases	**Audit areas affected** Lease classification. Disclosures.	**Impact of new accounting standards on Leases (IAS17)** There potentially could be an increased number of finance leases as IAS 17 gives a broader definition of finance leases than the previous UK GAAP standard (SSAP 21) resulting in more assets coming on to the balance sheet. **Our audit work** During our controls work we will assess the Council's process for ensuring that there is a complete record of all leases and these are reviewed under the requirements of IAS 17. During the final phase we will review all material leases and contracts to determine whether they been correctly treated as an operating lease or finance lease under IAS 17.

Key financial statement audit risks (cont.)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

Key audit risks	Impact on audit plan
Employee benefits → **Audit areas affected** Liabilities	**Impact of new accounting standard on Employee Benefits (IAS 19)** New liability to be recognised on the balance sheet when there is a requirement to pay wages and salaries, bonuses and particularly holiday pay. **Our audit work** During the audit of the re-stated 2009/10 balances we will assess whether the Council's payroll system can provide the information needed to calculate the obligation. During the final process we will audit the balance using the data collated by the Council to ensure it is line with the requirements of the standard.
Property, plant and equipment → **Audit areas affected** Tangible fixed assets	**Impact of new accounting standard for Property, Plant & Equipment (IAS 16)** Local authorities are to "component account" for any additions or valuations on or after 1 April 2010. This means when an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, each component is accounted for separately. **Our audit work** During our controls work we will assess the controls in place to ensure that additions/valuations are being addressed as components and appropriately recorded in the fixed asset register. During the final phase of our audit we will substantively test additions and valuations to ensure that these are correctly accounted for in line with the component requirements of IAS 16.

Key financial statement audit risks (cont.)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

Key audit risks	Impact on audit plan
Consolidations and associates → **Audit areas affected** Group accounts	**Expected impact of new accounting standards on Group Accounts (IAS 27 & 28)** UK GAAP emphasises the substance of control whereas IFRS considers the power to control. As a result there may be a different interpretation of those entities that should be consolidated which may require the Council to prepare Group Accounts for the first time. **Our audit work** During the audit of the re-stated 2009/10 balances we will consider the Council's evaluation of its relationships with external partners to assess whether they should now be consolidated under the new standards. If required, we will audit the consolidated statements during the final phase in line with IAS 27 & 28.
Financial standing / MTFP → **Audit areas affected** Reserves and balances Exceptional costs	**Financial standing/medium term financial planning** Local authorities are facing unprecedented pressure on their finances following the recent Government funding settlement. As with other parts of the organisation, the Council's Finance function will be affected by the Council's response to its reduced funding. There is a risk that any reductions in finance staff and increased workload will impact on the operation of financial controls and the accounts closedown process. Similarly, reductions to Internal Audit may impact on the assurance available regarding the control environment. **Our audit work** Linking with our use of resources audit work, we will consider the Council's general financial standing and in particular its approach to medium term financial planning. We will consider the potential impact of the outcome from this work on our audit, for example through our assessment of financial controls and reviewing any exceptional items that arise during the year (including pay and redundancy costs) through our financial statements audit.

Key financial statement audit risks (cont.)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

Key audit risks	Impact on audit plan
Financial systems **Audit areas affected** Various balances within the 2010/11 financial statements	**Financial systems** During our 2009/10 audit we identified a number of concerns over the operation of controls on the new SAP system and as a result we performed additional substantive testing for our year-end audit. **Our audit work** During the interim audit we will discuss with management our recommendations, highlighted to you in our 2009/10 report. We will also test the operation of controls to consider what assurance we can obtain from them. Given the work of Finance staff later in 2010 to address the control weaknesses, we are planning our audit on the assumption that we will be able to rely on key controls and avoid the significant additional substantive audit testing that was necessary last year. We will, however, reconsider this following the completion of our controls work. In particular, we will consider whether controls have operated effectively for a sufficient period during the financial year given the timing of our audit work last year and the subsequent work by Finance staff to address the identified issues. During our final phase of the audit we will audit and test any recommendations that have been implemented to ensure that the controls surrounding SAP are working effectively.

Key financial statement audit risks (cont.)

For each key risk audit area we have outlined the impact on our audit plan.

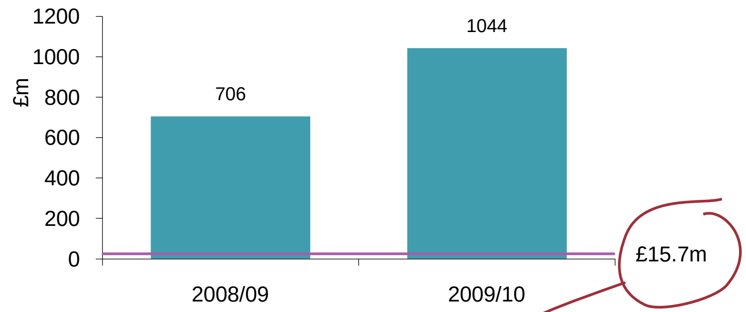
We will provide updates to the Audit Committee on these risk issues throughout our audit.

Key audit risks	Impact on audit plan
Accounting for Schools **Audit areas affected** Income and expenditure Property, plant and equipment	**Accounting for Schools** During 2008/09 and 2009/10, audit adjustments were made to the accounts to ensure the correct accounting of the disposal of assets for foundation schools. In addition, we identified a number of control weaknesses surrounding the reconciliations of year end school balances. **Our audit work** During the interim audit we will discuss and review any foundation school transactions that have occurred to ensure that the correct accounting treatment is appropriate and transactions have been accounted for correctly. We will consider whether the Council's approach to the schools' closing down procedure is appropriate.

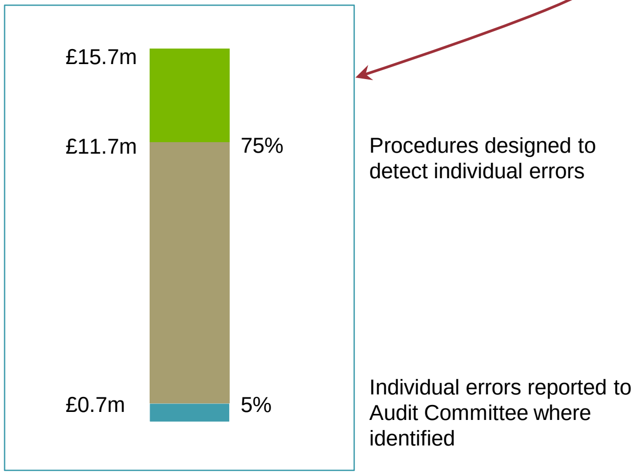
Materiality

Our audit work is planned to detect errors that are material to the accounts as a whole.

Gross operating expenditure



Overall materiality



Note: Materiality will be updated on receipt on the draft 2010/11 financial statements.
Source: 31 March 2010 financial statements.

What do we mean by materiality?

In layman terms, materiality is the margin of error we will accept before we qualify our opinion on the accounts.

Why do we have a level of materiality?

We only have a limited time in which to complete our work. As a result, we focus our testing on a sample of transactions rather than everything. To make our sample testing most effective, our work is driven by an assessment of risk and a level of materiality. This means we sample test the transactions that are more likely to be prone to significant fraud or error.

Determining materiality

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures. This includes our assessment of the Council's track record in preparing accounts.

Materiality has been set at £15.7m which is 1.5% of gross operating expenditure.

We design our procedures to detect errors at a lower level of precision, i.e. £11.7m. We have some flexibility to adjust this level downwards.

Reporting to Audit Committee

To comply with auditing standards, the following three types of audit differences will be presented to the Audit Committee:

- summary of adjusted audit differences;
- summary of unadjusted audit differences; and
- summary of disclosure differences (adjusted and unadjusted).

We will not report audit and disclosure differences that are considered to be trivial.

Individual errors above £0.7m will be reported to the Audit Committee where identified.

Independence confirmation

Our independence and objectivity responsibilities under the Code are summarised in Appendix 3.

We confirm our audit team's independence and objectivity is not impaired.

Independence and objectivity confirmation

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The ISA defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Confirmation statement

We confirm that as of the date of this report, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.

Audit fees

The audit fee has not changed from that agreed in the high level audit strategy in 2010.

We agreed our fee for the audit with the Council last year. The fee is calculated with reference to a number of factors including your turnover and our assessment of audit risk and control environment. This represents an increase of 9 per cent from the planned core audit fee of £399,750 for 2009/10. The increase is due to the additional audit costs associated with the implementation of IFRS, although the Council has been reimbursed directly by the Audit Commission for these one-off costs.

Element of the audit	
(£)	**Fee 2010/11**
Total audit fee	435,600
Less: IFRS Reimbursement	(24,506)
Audit fee payable by Wiltshire Council	**411,094**

To enable you to benchmark our fee proposal we provide below some comparative information. Please note that the nature of the locally determined work changes each year so that direct comparison between years may not be valid.

Source of fee comparative/benchmark	
	(£)
Audit commission suggested fee range	331,888-518,575
Audit commission suggested scale fee	414,860
Actual 2010/11 audit fee	435,600

Audit fees (cont.)

Our audit fee is indicative and based on you meeting our expectations of your support.

Meeting these expectations will help to the delivery of our audit within the proposed audit fee.

Audit fee assumptions

The audit fee is indicative and is based on you meeting our agreed expectations as outlined in Appendix 2. In setting the fee, we have assumed:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform us of any significant developments impacting on our audit;
- you will identify and implement any changes required under the CIPFA Code of Practice on Local Authority Accounting within your 2010/11 financial statements (note 2010/11 is the first year based on IFRS);
- your financial statements are made available for audit in line with the agreed timescales;
- you will make available the re-stated 2009/10 figures in line with the agreed timescales and ensure they are in line with IFRS requirements;
- good quality working papers and records will be provided at the start of the final accounts audit;
- requested information will be provided within the agreed timescales;
- prompt responses will be provided to queries and draft reports;
- internal audit meets appropriate professional standards;
- internal audit completes appropriate work on all systems that provide material figures for the financial statements and we can place reliance on them for our audit;
- additional work will not be required to address questions or objections raised by local government electors.

Meeting these expectations will help ensure the delivery of our audit within the agreed audit fee.

Changes to the audit plan

Changes to this plan and the audit fee may be necessary if:

- new significant audit risks emerge;
- additional work is required of us by the Audit Commission or other regulators;
- additional work is required as a result of changes in legislation, professional standards or financial reporting requirements.

If changes to this plan and the audit fee are required, we will discuss and agree these initially with the Chief Financial Officer.

Audit timeline and deliverables

Our key deliverables will be delivered to a high standard and on time.

We will discuss and agree each report with the Council's officers prior to publication.

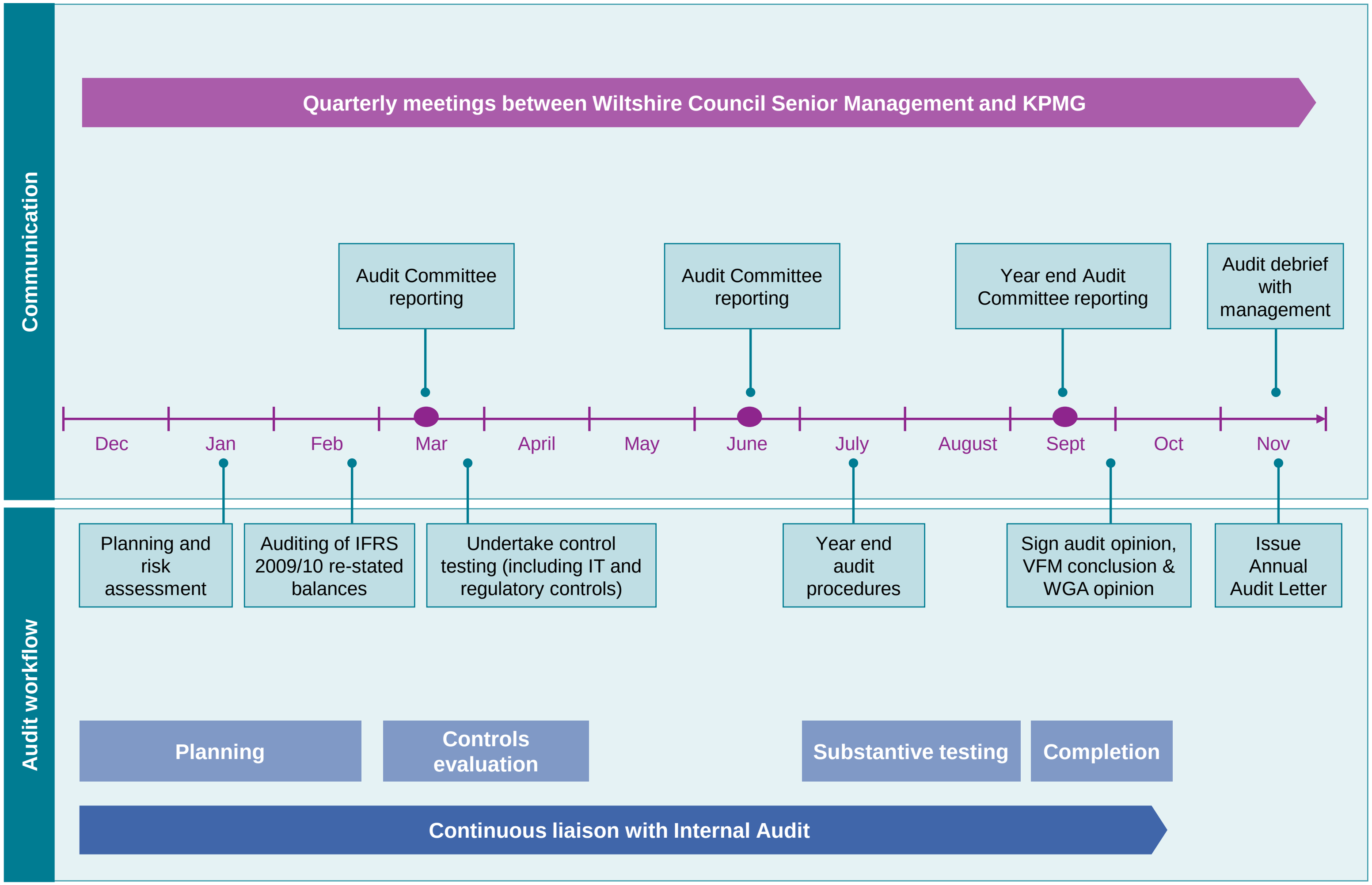
Deliverable	Purpose	Timing
Planning		
Audit plan	Outline audit approach Identify areas of audit focus and planned procedures Confirm plan with Audit Committee	**February/March 2011**
Interim		
Interim report	Details and resolution of control and process issues	**June 2011**
Report on re-stated 2009/10 figures	Feedback on audit work undertaken on 2009/10 restated balances in line with IFRS Identify areas of improvement to ensure 2010/11 financial statements are fully compliant with IFRS	**June 2011**
Year end audit		
Report to those charged with governance (ISA 260)	Commentary on Wiltshire Council financial statements Commentary on Wiltshire Council value for money arrangements Details the resolution of key audit issues Communication of adjusted and unadjusted audit differences Performance improvement recommendations identified during our audit	**September 2011**
Opinion on financial statements	Independent auditors' report to the Members of Wiltshire Council Independent auditors' report on the Whole of Government Accounts pack	**September 2011**
Annual audit letter	Summaries the audit we have performed with key audit issues and outputs	**November 2011**

Audit timeline and deliverables (cont.)

Key formal interactions with the Audit Committee are:

- **March: discuss audit plan and key audit risks.**
- **June: IFRS and interim issues.**
- **September: Year end conclusions.**

We will be in continuous dialogue with finance staff and management throughout the audit.



Key: ● Audit Committee meetings

Appendix 1: Meeting your expectations

How we will conduct ourselves

Communications

We will be proactive in developing relationships with your staff where our audit work requires their input.

We will ensure that all letters and emails are answered within five working days of receipt. All telephone messages received will receive a response within 24 hours, either by the individual concerned or by Rachael Tonkin.

We will ensure that all recommendations, and in particular those relating to our performance management work, are included within our Annual Audit Letter only after having been agreed with relevant Directors.

Chris Wilson, Darren Gilbert or Rachael Tonkin will attend Audit Committee meetings and ensure that other relevant KPMG staff are invited as appropriate.

We have been working with you throughout 2009/10 providing guidance on key issues in the transition to IFRS. We will continue working with the finance team to provide advice and review progress during 2010/11.

Working together

We will ensure that the Chief Financial Officer and other key members of staff are kept informed of the progress of our audit work throughout the year.

We will liaise with staff at all levels of the Council to ensure that our work is appropriately planned and completed and where recommendations are made these are agreed with the likely responsible officer.

Co-operating with the Council

We will continue to co-ordinate our work with that of internal audit and ensure that we provide appropriate proactive commentary to the finance function on issues that affect the Council's accounts.

We will respond promptly to requests for comment on aspects of the Council's operations, where appropriate.

Our expectations of your support

Audit Plan

Brief our staff on key issues affecting the Council.

Review and agree the draft plan.

Interim Audit

Facilitate the completion of internal audit's work (particularly on core financial systems) to timetable.

Ensure that key officers are available for the duration of our audit.

Respond to and agree our draft reports in good time.

Accounts Audit

Ensure that a full draft of the accounts is available at least one week prior to the agreed start date of our audit, and that only agreed adjustments are put into the accounts following receipt of this draft.

Produce the documents listed within our prepared by client request by the agreed start date of our audit.

Annual Audit Letter

Discuss and agree our draft Annual Audit Letter in good time for the Audit Committee.

Ensure that all action plans are agreed and followed up in due course.

IFRS

Ensure a full set of 2009/10 re-stated figures compliant with IFRS are available to audit in good time prior to the final visit.

Other work

Agree a key Council contact as a focal point for the study or work.

Discuss and review our findings so that action plans can be fully completed and implemented.

Appendix 2: Balance of internal controls and substantive testing

This appendix illustrates how we determine the most effective balance of internal controls and substantive audit testing

Emphasis of testing

What we do	Accounts/transactions suited to this testing	For example KPMG's approach to
Extensive controls testing Reduced substantive testing	Low value transactions High volume Homogenous transactions Little judgement	Income and debtors Purchases and payables Payroll
Moderate controls testing Moderate substantive testing	Low/medium value High/medium volume Some areas requiring judgement	Valuation of tangible fixed assets
Limited controls testing Extensive substantive testing	High value Low volume or Unusual non-recurring Accounting estimates Significant judgements	Valuation of intangibles Financial Instruments

Note: Assuming controls are found to operate as designed.

Appendix 3: Independence and objectivity requirements

This appendix summarises auditors' responsibilities regarding independence and objectivity.

Independence and objectivity

Auditors are required by the Code to:

- carry out their work with independence and objectivity;
- exercise their professional judgement and act independently of both the Commission and the audited body;
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest; and
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Council invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Any staff involved on Commission work who wish to engage in political activity should obtain prior approval from the Partner.
- Audit staff are expected not to accept appointments as lay school inspectors.
- Firms are expected not to risk damaging working relationships by bidding for work within an audited body's area in direct competition with the body's own staff without having discussed and agreed a local protocol with the body concerned.
- Auditors are expected to comply with the Commission's statements on firms not providing personal financial or tax advice to certain senior individuals at their audited bodies, auditors' conflicts of interest in relation to PFI procurement at audited bodies, and disposal of consultancy practices and auditors' independence.
- Auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission.
- Auditors are expected to comply with the Commission's policy for the Engagement Lead to be changed on each audit at least once every five years (although this can be extended up to seven years). Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- The Commission must be notified of any change of second in command within one month of making the change. Where a new Engagement Lead or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.

Appendix 4: Quality assurance and technical capacity

We continually focus on delivering a high quality audit. This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff. Quality must build on the foundations of well trained staff and a robust methodology. The diagram summarises our approach and each level is expanded upon below.

We recruit the best staff through our rigorous selection and assessment criteria. In addition, we expect that future talent to develop with our application of most effective in-house and external training support.

Our audit methodology determines that we use a standardised audit approach and pro forma work papers. We also have standards of audit evidence and working papers including requirements for working paper retention.

At critical periods of the audit we conduct both manager and engagement leader review of the work completed. Upon final completion, managers and directors complete a checklist to indicate the satisfactory conclusion of the audit under the audit methodology.

Partners who meet certain skills and experience criteria, conduct quality control reviews of individual audits depending on the level of audit risk. Their role is to perform an objective evaluation of the significant accounting, auditing and financial reporting matters with a high degree of detachment from the audit team. This provides an objective internal assessment on the quality of our audit. Peer review is undertaken across the firm, with an annual sample of our work being undertaken from a different national office. This encourages a constant focus on quality and ensures there is continuous improvement and that best practice is shared.

Our quality review results

We are able to evidence the quality of our audits through the results of National Audit Office and Audit Commission reviews. The results of the Audit Commission's annual quality review process is made publicly available each year (www.audit-commission.gov.uk/reports/). The latest report dated October 2010 showed that we performed highly against all the Commission's criteria.

Appendix 4: Quality assurance and technical capacity (cont.)

Resolving accounting and financial report Issues and emerging issues with the independent regulator

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director (based in our London office) who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA and the Audit Commission) as well as acting as a sounding board for our auditors.
- A national technical network of public sector audit professionals (that meets on a quarterly basis) and is chaired by our national technical director.
- All of our staff have a searchable accounting data base (Alex) that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's Code of Audit Practice.
- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based bi-monthly technical training.

When dealing with the Audit Commission, as you would expect we both attend and cascade across the firm the papers considered by their various technical groups for auditors. In addition, as the Audit Commission has developed we have established a series of formal and informal relationships. These benefit both the Audit Commission and our Local Authority clients. As a result of all of these factors, and combined with our overall audit approach, we seek to offer early warnings of issues arising with the independent regulator and provide pragmatic solutions.

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